FINANCIAL SECTOR REFORM (HAYNE ROYAL COMMISSION RESPONSE – PROTECTING CONSUMERS (2019 MEASURES)) BILL 2019

REPLACEMENT EXPLANATORY MEMORANDUM

(Circulated by authority of the Treasurer, the Hon Josh Frydenberg MP)

THIS MEMORANDUM REPLACES THE EXPLANATORY MEMORANDUM PRESENTED TO THE HOUSE OF REPRESENTATIVES ON 28 NOVEMBER 2019
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The following abbreviations and acronyms are used throughout this Explanatory Memorandum.

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<tr>
<td>ASIC</td>
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General outline and financial impact

Implementing Recommendation 4.7 of the Financial Services Royal Commission

Schedule 1 to the Bill gives effect to recommendation 4.7 of the Financial Services Royal Commission to extend the existing protections of the unfair contract terms regime under the Australian Securities and Investments Commission Act 2001 to insurance contracts governed by the Insurance Contracts Act 1984.

Date of effect: The amendments commence on 5 April 2021. The unfair contract terms regime will apply to insurance contracts that are new or renewed after the commencement date. The amendments will also apply to terms of a contract varied after the commencement date.

Proposal announced: The Government announced that it would extend the unfair contract terms regime to insurance contracts on 4 February 2019 as part of the Government’s response to the Financial Services Royal Commission.

Financial impact: This Schedule has no financial impact

Human rights implications: This Schedule does not raise any human rights issues. See Statement of Compatibility with Human Rights — Chapter 4, paragraphs 4.1 to 4.4.

Compliance cost impact: The compliance costs for insurers are likely to be low. 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 for insurers.

The Financial Services Royal Commission Final Report has been certified as being informed by a process and analysis equivalent to a Regulation Impact Statement for the purposes of the Government decision to implement this reform.¹

¹ The full regulation impact statement can be accessed online through the Australian Parliament House website: https://parlinfo.aph.gov.au/parlInfo/search/display/display.w3p;adv=yes;orderBy=date-eFirst;page=1;query=%22Royal%20Commission%22%20Date%3A01%2F02%2F2019%20%3A01%2F02%2F2019%20Dataset%3Atabledpapers;rec=9;resCount=Default
Implementing Recommendation 4.2 of the Financial Services Royal Commission

Schedule 2 to the Bill gives effect to recommendation 4.2 of the Financial Services Royal Commission to ensure that the consumer protection provisions of the *Australian Securities and Investments Commission Act 2001* apply to funeral expenses policies.

**Date of effect:** The amendments apply from the day after the Bill receives Royal Assent.

**Proposal announced:** As part of the response to the Financial Services Royal Commission, the Government announced on 4 February 2019 it would put beyond doubt that the consumer protection provisions of the *Australian Securities and Investments Commission Act 2001* apply to funeral expenses policies.

**Financial impact:** This Schedule has no financial impact

**Human rights implications:** This Schedule does not raise any human rights issues. See *Statement of Compatibility with Human Rights* — Chapter 4, paragraphs 4.5 to 4.8.

**Compliance cost impact:** This measure will result in low increases to compliance costs.

The Financial Services Royal Commission Final Report has been certified as being informed by a process and analysis equivalent to a Regulation Impact Statement (RIS) for the purposes of the Government decision to implement this reform.²

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**Mortgage brokers**

Schedule 3 to the Bill amends the Credit Act to require mortgage brokers to act in the best interests of consumers; and address conflicted remuneration for mortgage brokers.

**Date of effect:** 1 July 2020

**Proposal announced:** This Schedule implements the Government’s response to recommendations 1.2 and 1.3 of the Royal Commission into

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² The full regulation impact statement can be accessed online through the Australian Parliament House website: https://parlinfo.aph.gov.au/parlInfo/search/display/display.w3p;adv=yes;orderBy=date-eFirst;page=1;query=%22Royal%20Commission%22%20Date%3A01%2F02%2F2019%20%3E%3E%2028%2F02%2F2019%20Dataset%3Atabledpapers;rec=9;resCount=Default

**Financial impact:** The Schedule has no financial impact.

**Human rights implications:** This Schedule does not raise any human rights issue. See *Statement of Compatibility with Human Rights* — Chapter 4, paragraphs 4.9 to 4.13.

**Compliance cost impact:** The Office of Best Practice Regulation has agreed to the estimates of annual average compliance costs for the measures relating to the two recommendations, as follows:

- 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.

The Financial Services Royal Commission Final Report has been certified as being informed by a process and analysis equivalent to a Regulation Impact Statement (RIS) for the purposes of the Government decision to implement this reform.³

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³ The full regulation impact statement can be accessed online through the Australian Parliament House website: [https://parlinfo.aph.gov.au/parlInfo/search/display/display.w3p;adv=yes;orderBy=dat-eFirst;page=1;query=%22Royal%20Commission%22%20Date%3A01%2F02%2F2019%20%3E%3E%2028%2F02%2F2019%20Dataset%3Atabledpapers;rec=9;resCount=Default](https://parlinfo.aph.gov.au/parlInfo/search/display/display.w3p;adv=yes;orderBy=date-eFirst;page=1;query=%22Royal%20Commission%22%20Date%3A01%2F02%2F2019%20%3E%3E%2028%2F02%2F2019%20Dataset%3Atabledpapers;rec=9;resCount=Default)
Chapter 1
Implementing Recommendation 4.7 of the Financial Services Royal Commission

Outline of chapter

1.1 This Chapter provides an overview of the amendments in Schedule 1 to the Bill to give effect to recommendation 4.7 of the Financial Services Royal Commission to extend the existing protections of the unfair contract terms regime under the Australian Securities and Investments Commission Act 2001 to insurance contracts governed by the Insurance Contracts Act 1984.

Context of amendments

1.2 Many businesses use standard form contracts to engage with consumers. These contracts generally set out terms on a ‘take it or leave it basis’ which means consumers are unlikely to be able to negotiate with the business if they believe elements of their standard form contract are unfair.

1.3 To address this problem the unfair contract terms regime was introduced in 2010 to protect consumers from unfair contractual terms in standard form contracts. A term in a relevant standard form consumer contract is void if it is unfair. The rest of the contract continues to bind the parties if it is capable of operating without the unfair term. A court can declare that a term in a relevant standard form consumer contract is unfair on application by a party to the contract or ASIC. The regime was extended to small business contracts in 2016. Insurance contracts covered by the Insurance Contracts Act 1984 have always been specifically excluded from the unfair contracts terms regime.

1.4 A range of government and independent inquiries since 2010 have recommended that the unfair contract terms regime should be extended to insurance contracts, including:

- Recommendation 4.7 of the Financial Services Royal Commission in 2019;\(^4\)
- Recommendation 6 of the Australian Competition and Consumer Commission first interim report in the Northern Australia Insurance inquiry in 2018;\(^5\)

\(^4\) Page 308 of Volume 1 of the Financial Services Royal Commission Final Report.
1.5 Following the 2017 Senate Economics Committee inquiry into the general insurance industry, the Government announced it would extend the unfair contract terms regime to insurance contracts. In June 2018, the Government published a proposals paper outlining a potential model for extending the regime.

1.6 In February 2019, the Financial Services Royal Commission recommended applying the unfair contract terms regime in the Australian Securities and Investments Commission Act 2001 to contracts regulated under the Insurance Contracts Act 1984. The Financial Services Royal Commission also recommended adjusting the regime in its application to insurance contracts by defining the main subject matter for insurance contracts as the terms of the contract which describe what is being insured. The Government agreed to implement this recommendation in full.

1.7 The Financial Services Royal Commission also noted that over-prescription and excessive detail in legislation can undermine regulation. Such detail can shift responsibility for behaviour away from regulated entities and result in a ‘box-ticking’ approach, rather than ensuring they comply with the fundamental norms of behaviour that should guide their conduct. Commissioner Hayne considered that a clearer focus on those fundamental norms in the primary legislation and subordinate instruments will improve the regulatory architecture and ensure that the intent of the law is met.

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5 Page 151 of the Australian Competition and Consumer Commission Northern Australian Insurance Inquiry First Interim Report.
6 Page 49 of the 2018 Parliamentary Joint Committee on Corporations and Financial Services inquiry into the life insurance industry Final Report.
7 Page 65 of the 2017 Senate Economics Inquiry into the general insurance industry Final Report.
9 Pages 4-5 of the Government Response to the 2017 Senate Economics Committee Inquiry into the general insurance industry.
The Government also agreed to identify the norms of behaviour and principles that underpin legislation as part of the legislative simplification process (recommendation 7.4 of the Financial Services Royal Commission). The norm underlying this Bill is that insurers should not include terms in their standard form contracts that are unfair to the other party.

Summary of new law

There are two key components in the Bill.

First, the Bill amends the Insurance Contracts Act 1984 to enable the unfair contract terms regime under the Australian Securities and Investments Commission Act 2001 to apply to insurance contracts covered by the Insurance Contracts Act 1984.

Secondly, the Bill amends the Australian Securities and Investments Commission Act 2001 to tailor the existing unfair contract terms regime in its application to insurance contracts. These changes are listed below:

- **Main subject matter**: The Australian Securities and Investments Commission Act 2001 presently excludes terms that define the main subject matter of a contract from the unfair contract terms regime. The Bill will amend the Australian Securities and Investments Commission Act 2001 to provide that the main subject matter of an insurance contract is limited to the description of what is being insured.

- **Transparent excess terms**: The Bill will amend the Australian Securities and Investment Commission Act 2001 to exclude terms that set the quantum of the excess or deductible in an insurance contract from the unfair contract terms regime as long as they are presented transparently.

- **Third party beneficiary**: The Bill will amend the Australian Securities and Investment Commission Act 2001 to allow for third party beneficiaries of insurance contracts to bring actions against insurers under the unfair contract terms regime.

Under the Insurance Contracts Act 1984 parties to insurance contracts have an obligation to act with the utmost good faith. The Bill does not impact this obligation, with the duty of the utmost good faith operating independently of the unfair contract terms regime.
Diagram 1.1 provides a high level summary of the operation of the unfair contract terms regime, with changes made by this Bill in red italics.

**Diagram 1.1 Summary of the operation of the unfair contract terms regime for financial products and services**

<table>
<thead>
<tr>
<th>New law</th>
<th>Current law</th>
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<tbody>
<tr>
<td>The unfair contract terms regime will apply to insurance contracts covered by the Insurance Contracts Act 1984.</td>
<td>Insurance contracts covered by the Insurance Contracts Act 1984 are excluded from the unfair contract terms regime.</td>
</tr>
<tr>
<td>Terms that define the main subject matter of an insurance contract will be excluded from the unfair contract terms regime.</td>
<td>Terms that define the main subject matter of a contract are excluded from the unfair contract terms regime.</td>
</tr>
<tr>
<td>Terms defining the upfront price payable of an insurance contract will be excluded from the unfair contract terms regime.</td>
<td>The unfair contract terms regime does not apply to insurance contracts covered by the Insurance Contracts Act 1984.</td>
</tr>
<tr>
<td>Terms defining the quantum or existence of the excess or deductible of an insurance contract will be excluded from the unfair contract terms regime if they are disclosed upfront and are transparent.</td>
<td>The unfair contract terms regime does not apply to insurance contracts covered by the Insurance Contracts Act 1984.</td>
</tr>
</tbody>
</table>

**Comparison of key features of new law and current law**

1.3 Note: A separate unfair contract terms regime operates under the National Consumer Law for non-financial products. As explained in 1.18, contracts of medical indemnity insurance are regulated separately and not subject to this unfair contract terms regime.
Implementing Recommendation 4.7 of the Financial Services Royal Commission

<table>
<thead>
<tr>
<th>Third party beneficiaries of an insurance contract covered by the regime will be able to bring a claim under the unfair contract terms regime. Third parties to other kinds of contracts will continue to be unable to bring claims.</th>
<th>The unfair contract terms regime does not allow third party beneficiaries to bring a claim.</th>
</tr>
</thead>
<tbody>
<tr>
<td>The duty of the utmost good faith will continue to apply to insurance contracts concurrently with the unfair contract terms regime.</td>
<td>The duty of the utmost good faith applies to insurance contracts.</td>
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Detailed explanation of new law

**Extending the unfair contract terms regime to apply to insurance contracts**

1.14 Section 15 of the *Insurance Contracts Act 1984* currently prevents insurance contracts being made subject to relief under any other Commonwealth Acts on the grounds that the contract is harsh, oppressive, unconscionable, unjust, unfair or inequitable.

1.15 To allow the unfair contract terms regime to apply to insurance contracts, section 15 of the *Insurance Contracts Act 1984* is amended to enable relief relating to the unfair contract terms regime in section 12BF of the *Australian Securities and Investments Act 2001* to apply to insurance contracts. A definition of ‘Insurance Contracts Act insurance contract’ is also added to the *Australian Securities and Investments Commission Act 2001*. [Schedule 1, items 1 and 9, subsection 12BA(1) of the Australian Securities and Investments Commission Act 2001 and subsection 15(2) of the Insurance Contracts Act 1984]

1.16 The unfair contract terms regime will not be extended to cover medical indemnity insurance contracts. Medical indemnity insurance is subject to a separate regulatory regime under the *Medical Indemnity Act 2002* and other related Acts. [Schedule 1, item 5, subsection 12BL(1A) of the Australian Securities and Investments Commission Act 2001]

**Applying the current unfair contract terms regime to insurance contracts**

1.17 The central elements of the existing unfair contract terms regime will apply to insurance contracts. The amendments provide that the unfair contract terms regime applies to insurance contracts covered by the *Insurance Contracts Act 1984* where:

- at least one party to the contract is a consumer or a small business (as defined in subsections 12BF(3) and (4) of the
An insurance contract can be a standard form contract even if a consumer can choose between several options such as levels of premium, excess or sum insured. The criteria for determining whether an insurance contract is standard form is outlined in subsection 12BK(2) of the Australian Securities and Investments Commission Act 2001 and includes factors like bargaining power and opportunity to negotiate terms, amongst other factors.

Similarly, an insurance contract can still be a standard form contract if it is intermediated by a broker as long as the circumstances of the case meet the criteria in subsection 12BK(2) of the Australian Securities and Investments Commission Act 2001 for determining whether a contract is a standard form contract.

Example 1.1

Matthew is a consumer wishing to purchase home contents insurance. He owns a laptop and camera that he also wants to make sure is insured but he is confused by the complexity of the insurance products he researches online. He requests that a broker recommend the best insurance policy. The broker, acting for Matthew, seeks contracts from several insurers, including contents policies that offer portable items cover as an optional extra. The standard form contract is prepared by the insurer without taking into account Matthew’s specific characteristics and the broker does not negotiate any contract terms on Matthew’s behalf. These contracts would be considered standard form contracts and Matthew, as the party to the contract, has standing to bring an action under the unfair contract terms regime.

Example 1.2

Anne, aged 45, is a busy mother of 3 who applies online with Life Insurer X for Death and Total and Permanent Disability cover up to the value of $150,000. After she answers some medical eligibility questions her application is accepted on standard terms. This would be considered a standard form contract and Anne, as the party of the contract, could bring action under the unfair contracts terms regime.

Example 1.3

Elissa is a 30-year old GP who applies for life insurance cover via her financial adviser. Her financial adviser assists her in completing the application. As part of her application, Melissa answers a number of medical and occupational questions. Based on her responses, the insurer issues her with Death, Total and Permanent Disability and
Implementing Recommendation 4.7 of the Financial Services Royal Commission

Disability Income Insurance to the value she applied for at standard rates. This would be considered a standard form contract and Elissa, as the party to the contract, has standing to bring action under unfair contract terms regime.

Example 1.4

BBB Limited is a small business seeking professional indemnity insurance. BBB Limited requests that a broker recommend the best insurance policy. The broker, acting for BBB Limited, seeks quotes from several insurers. In preparing the contracts, the broker negotiates changes to a number of specific clauses to suit the nature of BBB Limited’s business. These contracts would not be considered standard form contracts and BBB Limited, as the party to the contract, cannot take action under the unfair contract terms regime.

1.20 If an insurance contract is subject to the unfair contract terms regime, a term in that insurance contract may be declared unfair and therefore void. A term is considered unfair if it meets all three criteria in section 12BG of the *Australian Securities and Investments Commission Act 2001* which currently apply to general contracts. These criteria are that the term:

- would cause a significant imbalance in the parties’ rights and obligations arising under the contract; and
- is not reasonably necessary in order to protect the legitimate interests of the party that would be advantaged by the term; and
- would cause detriment to a party if it were to be applied or relied on.

1.21 Section 12BH of the *Australian Securities and Investments Commission Act 2001* sets out examples of terms which could be unfair. These examples are intended to be product-neutral and apply across a wide variety of financial contracts. In some cases they may be not relevant for insurance products, for example a term that guarantees the insured (but not the insurer) the ability to renew an insurance contract is unlikely to be considered unfair.

1.22 The court will determine whether unfairness arises in a particular contract on a case-by-case basis.

1.23 Further examples of terms which could be unfair in an insurance contract include:

- a term that allows the insurer to, instead of making a repair, elect to settle the claim with a cash payment calculated according to the cost of repair to the insurer, rather than how much it would cost the insured to make the repair;
• a term that is an unnecessary barrier to the insured lodging a legitimate claim (for example, requiring the payment of a large excess before the insurer considers a claim or requiring the insured to lodge the claim within an unreasonably short timeframe);

• a term in a contract that contains unexpected payment arrangements (for example, that would enable the insurer to unilaterally start making direct debit deductions to an account of the consumer despite the consumer selecting a different payment method);

• a term in a disability insurance contract that uses an outdated, and therefore inaccurate and restrictive, medical definition to determine whether the consumer meets the criteria to be eligible to have a claim paid; or

• a term in a contract that significantly reduces the cover offered where compliance with the preconditions for being covered is unfeasible (for example, a term in a travel insurance policy that only covers loss of luggage when it has been personally attended by the insured at all times).

1.24 While it is ultimately a matter for the court to determine whether a term is unfair, many terms in insurance contracts will be reasonably necessary to protect the legitimate interests of the insurer. For example, a term in a life policy within the meaning of the Life Insurance Act 1995 that allows the insurer to unilaterally increase premiums would not be considered unfair if it was used in response to a change in the actuarial pricing of risk required to underwrite the policy. Similarly, specific terms in standard form contracts may be required for an insurer to obtain any reinsurance from a third party or appropriately reflect the underwriting risk accepted by the insurer. Depending on the circumstances of the case, such terms may be reasonably necessary to protect the insurer’s legitimate interests.

1.25 Section 12BI of the Australian Securities and Investments Commission Act 2001 prevents some terms in a contract from being considered unfair, including the main subject matter of the contract, the upfront price payable and any term required by a law of the Commonwealth, a State or a Territory.

1.26 The main subject matter of a contract is undefined in the current law. For insurance contracts, the main subject matter will be defined (see below).

1.27 The upfront price payable under a contract is currently defined in subsection 12BI(2) of the Australian Securities and Investments Commission Act 2001. This definition will apply to insurance contracts,
meaning that the insurance premium paid, as long as it meets the criteria of subsection 12BI(2) of the *Australian Securities and Investments Commission Act 2001*, cannot be considered unfair. See below for a discussion of excesses and deductibles in insurance contracts.

1.28 Terms required, or expressly permitted, by a law of the Commonwealth or a State or Territory are not covered by the unfair contract terms regime (see section 12BL of the *Australian Securities and Investments Commission Act 2001*). For insurance contracts, this would include terms defined in the standard cover regime and the definition of ‘flood’ in regulation 34 of the *Insurance Contracts Regulations 2017*.

1.29 Section 12BF of the *Australian Securities and Investments Commission Act 2001* provides that a term in a relevant standard form consumer contract is void if it is unfair. If there is a dispute as to whether a term is unfair, the parties or ASIC can seek a declaration from the court under section 12GND of the *Australian Securities and Investments Commission Act 2001* that the contractual term is unfair. The court’s ability to do this does not limit its ability to make other declarations which may include declarations that the term is only unfair in the circumstances of the case at hand. This will also be the case for insurance contracts. The only difference will be that in the case of insurance contracts, third party beneficiaries will also have the right to seek the court’s declaration that a contractual term is unfair (see below).

1.30 Subsection 12BF(2) of the *Australian Securities and Investments Commission Act 2001* provides that an insurance contract will continue to bind the parties if it is capable of operating without the unfair term. This will also be the case for insurance contracts.

1.31 For the avoidance of doubt, the unfair contract terms regime does not affect the rights and obligations of parties to insurance contracts that are outlined in the *Insurance Contracts Act 1984*.

*Changes made to the unfair contract terms regime in its application to insurance contracts*

1.32 The *Australian Securities and Investments Commission Act 2001* is amended to tailor the application of the general unfair contract terms regime to insurance contracts. This is in recognition of the unique characteristics of insurance contracts.

*Main subject matter of an insurance contract*

1.33 Terms defining the main subject matter of any financial product or service contract are excluded from the unfair contract terms regime by section 12BI of the *Australian Securities and Investments Commission Act 2001*. The exclusion of terms that define the main subject matter of a standard form contract ensures that a party cannot challenge a term concerning the basis for the existence of the contract. This is in
recognition of the fact that the party had a choice whether or not to enter the contract on the basis of what was offered.

1.34 In line with Financial Services Royal Commission recommendation 4.7, for insurance contracts, the main subject matter is limited to the extent that the term describes what is being insured. 

*SCHEDULE 1, item 4, subsection 12BI(4) of the Australian Securities and Investments Commission Act*

1.35 Commissioner Hayne considered that the benefits of extending the unfair contract terms regime to insurance contracts would be undermined if a broader definition of what terms define the main subject matter were adopted.

1.36 Where a term describes what is being insured and is the basis for the existence of the contract, that term is the main subject matter of the contract and not subject to the unfair contract regime. While it is anticipated that relatively few terms in insurance contracts will qualify for this exemption, this will be determined on a case by case basis.

**Example 1.5**

Isla purchases home insurance for a house at 17 Drayton Street. The contract describes the house as a four bedroom, brick veneer freestanding house. This description (a four bedroom, brick veneer freestanding house at 17 Drayton St) is the main subject matter of the contract and therefore outside of the unfair contract terms regime.

**Example 1.6**

Jess purchases car insurance. The contract describes the car as a 2018 Kia Carnival S 2.2-litre four-cylinder turbo-diesel with a modification to take wheelchairs. This description (a 2018 Kia Carnival S 2.2-litre four cylinder turbo-diesel with a modification to take wheelchairs) is the main subject matter of the contract and therefore outside of the unfair contract terms regime.

1.37 For insurance contracts which are not property-based, it is expected that only terms that are the basis for the existence of the contract and describe the intangible thing being insured will be considered to define the main subject matter.

**Example 1.7**

Tom is a 46-year-old marine biologist who earns an income of $100,000 a year. He purchases income protection insurance for the value of $6,250 a month and discloses no significant ill health. The contract describes Tom as a 46-year old man with no significant ill health and also states the sum insured is $6,250 a month. Both the description of Tom and the statement of the sum insured are the main subject matter of the contract and therefore outside of the unfair contract terms regime.
Example 1.8

Yvonne buys life insurance cover for herself and her husband Bob, for the value of $100,000 for each life insured. The description of Yvonne, Bob and statement of the sum insured is the main subject matter of the contract and therefore outside of the unfair contract terms regime.

Transparent excess and deductible terms exclusion

1.38 Under current law, a term setting out the upfront price that is payable under a contract is excluded from the unfair contract terms regime (see section 12BI of the Australian Securities and Investments Commission Act 2001). However, the definition of upfront price payable does not encompass the excess or deductible of an insurance contract due to the exclusion from that definition of any consideration that is contingent on the occurrence or non-occurrence of a particular event (see subsection 12BI(2) of the Australian Securities and Investments Commission Act 2001). This means that terms setting the quantum or existence of any excesses or deductibles of an insurance contract are subject to the unfair contracts term regime and may be considered unfair.

1.39 Excesses and deductibles are similar, but slightly different types of terms under an insurance contract. Excesses are an amount contributed by the insured when making a claim under an insurance contract. Deductibles are an amount deducted from a payment made by an insurer as a result of a claim under an insurance contract.

1.40 Both excesses and deductibles can be directly related to the upfront price of an insurance contract. A high upfront premium and a lower excess or deductible can be equivalent to a lower upfront premium and a higher excess or deductible. Subjecting excesses and deductibles to the unfair contract terms regime may simply result in insurers offering lower excesses and deductibles and higher premiums, which is not the policy intent.

1.41 Excesses and deductible terms should be subject to the unfair contract terms regime if they do not form the basis for the existence of the contract. Excesses and deductibles which the insured chooses to increase or decrease as part of the contract (with resulting premium changes) should not be subject to challenge. However, excesses or deductibles that do not form the basis for the existence of the contract should be subject to the unfair contract terms regime. As such, only terms that are transparent to the insured at the time of purchasing the contract are not subject to challenge under the unfair contract terms regime.

1.42 The Australian Securities and Investments Commission Act 2001 is amended so that a term in an insurance contract which sets out the quantum or existence of the excess or deductible payable under an insurance contract will be excluded from the unfair contract terms regime if the term is transparent (as defined in subsection 12BG(4) of the
Example 1.9

James renews his car insurance for a 2014 IS300 Lexus, paying a $500 premium. A ‘basic’ excess of $1000, payable when any claim is made, was clearly presented in the quote and also on the renewal notice. The quantum of the excess ($1000) is not subject to challenge under the unfair contract terms regime.

Third party beneficiaries

1.43 Under the existing unfair contract terms regime in the Australian Securities and Investments Commission Act 2001 a court can only declare that a term is unfair on application by a party to the contract or ASIC (see subsections 12GND(1) and (2) of the Australian Securities and Investments Commission Act 2001).

1.44 Third party beneficiaries of insurance contracts are recognised in the Insurance Contracts Act 1984 as having the ability to bring actions under that Act. This is because there are circumstances where they will be required to take action in the place of the contracting party. The Bill amends the Australian Securities and Investments Commission 2001 to allow third party beneficiaries of insurance contracts to also bring actions against insurers under the unfair contract terms regime. [Schedule 1, item 6, paragraphs 12GND(1)(c) and 12GND(2)(c) of the Australian Securities and Investments Commission Act 2001]

• For example, death benefit nominees under a life insurance policy or individuals covered under certain group insurance policies (e.g. policies purchased by small sporting associations on behalf of club members to cover personal injury incidents) are likely to be able to bring actions under the unfair contract terms regime in relation to contracts covered by the regime.

1.45 Third party beneficiaries are defined in the Insurance Contracts Act 1984 as a person who is not a party to the contract but is specified or referred to in the contract, whether by name or otherwise, as a person to whom the benefit of the insurance cover provided by the contract extends (see section 11 of the Insurance Contracts Act 1984).

1.46 The definitions of consumer and small business, tests of unfairness and definition of standard form contracts continue to relate to the parties to the insurance contract, not third party beneficiaries (see sections 12BF, 12BG and 12BK of the Australian Securities and Investments Commission Act 2001). This means that, while third party beneficiaries can bring actions, the actions will only be successful if the
tests of unfairness and standard form are met with reference to the parties that negotiated the contracts, not the third party beneficiaries.

- For example, a contract for insurance purchased on a group basis by a large superannuation trustee would likely not be covered by the regime. A superannuation trustee would be unlikely to meet the definition of a small business or consumer, and is likely to have significant bargaining power in negotiating such contracts, so the contract would not meet the definition of a standard form contract.

**The Duty of the Utmost Good Faith**

1.47 The *Insurance Contracts Act 1984* provides that parties to an insurance contract have a duty to act with the *utmost good faith* (see Part 2 of the *Insurance Contracts Act 1984*). The duty covers any matters in relation to the insurance contract including negotiation before the contract is signed and claims handling after a contract has been formed. The amendments in the Bill do not impact the existing operation of the duty of utmost good faith.

1.48 The *Insurance Contracts Act 1984* and *Australian Securities and Investments Commission Act 2001* have been amended to include notes to make it clear that the unfair contract terms regime and the duty of utmost good faith operate independently of one another. [*Schedule 1, item 2, section 12BF of the Australian Securities and Investments Commission Act 2001 and Schedule 1, item 8, section 12 of the Insurance Contracts Act 1984*]

1.49 A breach of the duty of the utmost good faith will not necessarily equate to a breach of the unfair contract terms regime. A breach of the unfair contract terms regime will not necessarily equate to a breach of the duty of the utmost good faith. Each regime operates independently of the other. However, it is possible that some scenarios may give rise to relief under both sets of provisions. In such scenarios, a party may bring actions before the court under either or both regimes, and the court will be able to take into account the concurrent operation of the two regimes when considering what orders to make.

**Application and transitional provisions**

1.50 The unfair contract terms regime will apply to new or renewed insurance contracts from the date of commencement of Schedule 1 to the Bill. Schedule 1 to the Bill will commence on 5 April 2021. A term of a contract varied after the commencement of Schedule 1 to the Bill will also be covered by the unfair contract terms regime. [*Schedule 1, items 7, section 324 of the Australian Securities and Investments Commission Act 2001, and item 10 of the Bill*]
1.51 Therefore, the application of the unfair contract terms regime to insurance will commence at the same time as the new Design and Distribution Obligations set out in *Treasury Laws Amendment (Design and Distribution Obligations and Product Intervention Powers) Act 2019*. This reduces the regulatory burden on industry compliance.
Chapter 2
Implementing Recommendation 4.2 of the Financial Services Royal Commission

Outline of chapter

2.1 This chapter provides an overview of the amendments in Schedule 2 to the Bill to implement recommendation 4.2 of the Financial Services Royal Commission to ensure that it is clear that the consumer protection provisions of the Australian Securities and Investments Commission Act 2001 apply to funeral expenses policies.

Context of amendments

Funeral expenses policies

2.2 The Financial Services Royal Commission uncovered evidence of the significant harm that can be caused to vulnerable consumers through the poor sales practices adopted by some funeral expenses policies providers.

2.3 Funeral expenses policies provide for the payment of funeral costs up to a nominated limit. The payout of the policy only covers the cost of the funeral or things incidental to it, but nothing else.

2.4 Commissioner Hayne observed that many funeral expenses policies are of little value because:

• the actual funeral costs incurred for a policyholder may be less than the nominated limit under the person’s policy; and

• the amount a policyholder pays in premiums over the life of a policy may be more than the amount that may be payable as a benefit (being actual funeral costs) under the person’s policy.

2.5 Funeral expenses policies are carved out from the definition of ‘financial products’ by paragraph 765A(1)(y) of the Corporations Act 2001 and regulation 7.1.07D of the Corporations Regulations 2001. The effect of the carve out is that 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 2001; and

• are not restrained by the anti-hawking provisions in the Corporations Act 2001.
2.6 The exemption of funeral expenses policies from the definition of financial products is also used by funeral directors to sell funeral expenses policies, issued by friendly societies, to consumers.

**The Financial Services Royal Commission Recommendation**

2.7 In recommendation 4.2 of the Financial Services Royal Commission, Commissioner Hayne recommended the removal of the exclusion of funeral expenses policies from the definition of financial products under the *Corporations Act 2001*.

2.8 Commissioner Hayne also recommended amending the *Australian Securities and Investments Commission Act 2001* to put beyond doubt that the consumer protection provisions under that Act apply to funeral expenses policies.

**Implementing the Government’s response to recommendation 4.2 of the Financial Services Royal Commission**

2.9 The Government’s response to the Financial Services Royal Commission, *Restoring trust in Australia’s financial system*, committed the Government to:

- remove the exemption for funeral expenses policies from the definition of financial products for the purposes of the *Corporations Act 2001*; and
- ensure that it is clear that the consumer protection provisions of the *Australian Securities and Investments Commission Act 2001* apply to funeral expenses policies.

2.10 This Bill gives effect to the Government’s commitment to implementing recommendation 4.2 of the Financial Services Royal Commission by making it clear that the consumer protection provisions of the *Australian Securities and Investments Commission Act 2001* apply to funeral expenses policies.

2.11 The *Treasury Laws Amendment (Financial Services Improved Consumer Protection) (Funeral Expenses Facilities) Regulations 2019* provides for the removal of the exemption for funeral expenses policies from the definition of financial products for the purposes of the *Corporations Act 2001*.

**Summary of new law**

2.12 The Bill amends the *Australian Securities and Investments Commission Act 2001* and *Corporations Act 2001* to ensure that it is clear that the consumer protection provisions of the *Australian Securities and Investments Commission Act 2001* apply to funeral expenses policies. The
amendments do not impact the treatment of prepaid funerals which continue to operate as funeral benefits.

**Detailed explanation of new law**

*Amendments to the Australian Securities and Investments Commission Act 2001*

2.13 Paragraph 12BAA(8)(o) currently provides that funeral benefits are not financial products and are therefore not subject to the consumer protection provisions of Part 2, Division 2 of the Australian Securities and Investments Commission Act 2001.

2.14 While this exemption does not extend to funeral expenses policies, a number of submissions to the Financial Services Royal Commission advocated for this to be made clear in the legislation.

2.15 Commissioner Hayne agreed and in recommendation 4.2 of the Financial Services Royal Commission, recommended making appropriate legislative amendments to put beyond doubt that the consumer protection provisions of the Australian Securities and Investments Commission Act 2001 apply to funeral expenses policies.

2.16 As such, to give effect to recommendation 4.2 of the Financial Services Royal Commission, section 12BAA of the Australian Securities and Investments Commission Act 2001 is amended to expressly specify that funeral expenses policies (described as funeral expenses facilities) are not funeral benefits for the purposes of the Australian Securities and Investments Commission Act 2001. [Schedule 2, item 1, subsection 12BAA(10) of the Australian Securities and Investments Commission Act 2001]

2.17 The Bill does not provide for a definition of a funeral expenses facility in the Australian Securities and Investments Commission Act 2001 as this has been included in the Corporations Act 2001 instead (see below). The definition in the Corporations Act 2001 will automatically flow through as a result of subsection 5(2) of the Australian Securities and Investments Commission Act 2001 which provides for relevant undefined terms to have the same meaning as in the Corporations Act 2001.

*Amendments to the Corporations Act 2001*

2.18 Paragraph 765A(1)(w) of the Corporations Act 2001 replicates paragraph 12BAA(8)(o) of the Australian Securities and Investments Commission Act 2001 to provide that funeral benefits are not financial products.
2.19 The *Corporations Act 2001* is amended to include a new provision that expressly provides that funeral expenses policies (described as funeral expenses facilities) are not funeral benefits. [*Schedule 2, item 4, section 765B of the Corporations Act 2001*]

2.20 This amendment has been made to ensure the definition of a funeral benefit is consistent in the *Australian Securities and Investments Commission Act 2001* and *Corporations Act 2001*, and to put beyond any doubt that a funeral expenses policy is not a funeral benefit.

2.21 Funeral expenses policies have been described as funeral expenses facilities to better describe the nature of the product. A definition of a funeral expenses facility has been included in section 761A of the *Corporations Act 2001*. [*Schedule 2, item 3, section 761A of the Corporations Act 2001*]

2.22 The definition of a funeral expenses facility reflects the description of a funeral expenses facility in section 11 of the *Life Insurance Act 1995*.

2.23 The description of a funeral expenses facility in the *Life Insurance Act 1995* was the basis for the definition of funeral expenses polices in regulation 7.1.07D of the *Corporations Regulations 2001* which is to be repealed separately as part of the Government’s commitment to give effect to recommendation 4.2 of the Financial Services Royal Commission.

2.24 The slight variation between the definitions in the *Life Insurance Act 1995* and the *Corporations Regulations 2001* does not have a substantive impact. In making these amendments, the original description of funeral expenses facilities in the *Life Insurance Act 1995* has been replicated to provide for consistent definitions across legislation.

2.25 To assist readers to navigate the legislation, a note is added to the definition of a funeral benefit in section 761A of the *Corporations Act 2001* to indicate that a funeral expenses facility is not a funeral benefit. [*Schedule 2, item 2, section 761A of the Corporations Act 2001 (at the end of the definition of funeral benefit)*]

2.26 The amendments in Schedule 2 to the Bill make it clear that the consumer protection provisions in the *Australian Securities and Investments Commission Act 2001* apply to funeral expenses policies and remove any possible doubt that funeral expenses policies will become a financial product once the exemption in regulation 7.1.07D of the *Corporations Regulations 2001* is removed.
Application and transitional provisions

2.27 The amendments apply from the day after Royal Assent.
Chapter 3
Mortgage brokers

Outline of chapter

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

- require mortgage brokers to act in the best interests of consumers; and
- address conflicted remuneration for mortgage brokers.

Context of amendments

3.2 Mortgage brokers assist consumers to obtain home loans by approaching and negotiating with lenders on consumers’ behalf. Mortgage brokers suggest particular loans to consumers based on information about the consumer and various loan products. However, most consumers do not pay mortgage brokers for their services. Instead, lenders generally pay mortgage brokers for their services by way of a fixed commission or a commission based on the size of the consumer’s loan. Mortgage brokers also receive volume-based commissions or ‘campaign-based’ commissions, which are paid on top of the standard commissions. Additionally lenders can provide other ‘soft-dollar’ or non-monetary benefits, such as training conferences and hospitality.

3.3 The Final Report of the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry considered mortgage broking in Australia and made recommendations relating to mortgage brokers, including recommendation 1.2 (the best interests duty) and recommendation 1.3 (mortgage broker remuneration). In response to the Royal Commission, the Government committed to a number of reforms in relation to the regulation of mortgage brokers including to:

- introduce a duty for mortgage brokers to act in the best interests of consumers; and
- address conflicted remuneration for mortgage brokers.

3.4 Requiring mortgage brokers to act in the best interests of consumers and addressing conflicted remuneration are intended to strengthen existing protections for consumers who deal with mortgage brokers. In particular, they bring the law into line with what consumers expect – that any advice provided by a mortgage broker serves the consumer’s interests first and foremost.
3.5 The best interests duty and the responsible lending obligations are separate obligations that operate alongside each other and apply every time credit assistance regulated by the Credit Act is provided by a mortgage broker. The best interests duty is not intended to duplicate these obligations. There are circumstances where the mortgage broker may not have acted in a consumer’s best interests even if the responsible lending obligations were complied with. For example, even if a home loan product is ‘not unsuitable’, recommending it to the consumer might not be in the consumer’s best interests.

3.6 The Credit Act concerns the provision of credit to consumers (where ‘consumer’ is defined in the Credit Act). As the mortgage broker reforms only amend the Credit Act, they do not apply to the provision of credit to businesses.

3.7 Within the mortgage broking market, businesses known as ‘aggregators’ operate between brokers and lenders by providing technology and administrative support (e.g. facilitating the processing of applications and providing training and professional development programs for brokers). Brokers also rely on aggregators because they have contractual arrangements with lenders, which allow the brokers operating under the aggregator to arrange loans from those lenders.\(^\text{14}\)

**Summary of new law**

3.8 Schedule 3 to the Bill amends the Credit Act to require mortgage brokers to act in the best interests of consumers and to address conflicted remuneration for mortgage brokers and mortgage intermediaries such as aggregators. These new laws improve consumer outcomes by requiring brokers to act in the best interests of their clients and by reducing the potential for conflicts of interests to arise which may impact the advice consumers receive from brokers.

3.9 The key features of the new law are:

- mortgage brokers must act in the best interests of consumers in relation to credit assistance in relation to credit contracts;
- where there is a conflict of interest, mortgage brokers must give priority to consumers in providing credit assistance in relation to credit contracts;
- mortgage brokers and mortgage intermediaries must not accept conflicted remuneration;

employers, credit providers and mortgage intermediaries must not give conflicted remuneration to mortgage brokers or mortgage intermediaries; and

• the circumstances in which these bans on conflicted remuneration apply are to be set out in the regulations.

Comparison of key features of new law and current law

<table>
<thead>
<tr>
<th>New law</th>
<th>Current law</th>
</tr>
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<tbody>
<tr>
<td>Mortgage brokers are required to act in the best interests of their clients and to prioritise their clients’ interests when providing credit assistance.</td>
<td>No equivalent.</td>
</tr>
<tr>
<td>Regulations can restrict the circumstances in which conflicted remuneration can be given or received in connection with credit services provided by mortgage brokers and intermediaries.</td>
<td>No equivalent.</td>
</tr>
</tbody>
</table>

Detailed explanation of new law

3.10 Schedule 3 to the Bill amends the Credit Act to
• require mortgage brokers to act in the best interests of consumers; and
• address conflicted remuneration.

3.11 The objective of the new law is to improve consumer outcomes. Firstly, by requiring mortgage brokers to act in the best interests of their clients and secondly, by reducing the potential for conflicts of interests to impact the advice consumers receive from mortgage brokers. [Schedule 3, item 5, section 158K of the Credit Act]

3.12 The new law expressly clarifies that the obligations it imposes are in addition to any other obligations to which the person is subject under the Credit Act or any other law. This ensures that the new law does not affect existing laws that protect or otherwise benefit consumers. [Schedule 3, item 5, section 158KC of the Credit Act]

Meaning of mortgage broker and mortgage intermediary

3.13 The new law imposes obligations on mortgage brokers and mortgage intermediaries.
3.14 A mortgage broker, for the purposes of the new law, can be either a licensee or a credit representative of a licensee that carries on a mortgage broking business. In particular the new law defines a mortgage broker as a licensee or a credit representative of a licensee that:

- carries on a business of providing credit assistance in relation to credit contracts secured by mortgages over residential property; [Schedule 3, items 3 and 4, subsection 5(1) definition of ‘mortgage broker’ and paragraphs 15B(1)(a) and 15B(2)(a) of the Credit Act]

- does not perform the obligations, or exercise the rights, of a credit provider in relation to the majority of those credit contracts; and [Schedule 3, items 3 and 4, subsection 5(1) definition of ‘mortgage broker’ and paragraphs 15B(1)(b) and 15B(2)(b) of the Credit Act]

- in carrying on the business, provides credit assistance in relation to credit contracts offered by more than one credit provider. [Schedule 3, item 3 and 4, subsection 5(1) definition of ‘mortgage broker’ and paragraphs 15B(1)(c) and 15B(2)(c) of the Credit Act]

3.15 ‘Carrying on a business’ is intended to take its general legal meaning. This means that there would be a number of different factors to consider when determining if an entity is carrying on a business, including the degree to which the credit assistance activities are conducted with system, repetition and continuity. If an entity advertises that it provides credit assistance in relation to credit contracts secured by mortgages over residential property, this would likely indicate that it carries on a business of doing so.

3.16 Credit assistance is an existing term that is defined in section 8 of the Credit Act. It covers a broad range of conduct engaged in by a person dealing directly with the consumer or the consumer’s agent in the course of, as part of, or incidentally to, a business carried on in this jurisdiction and relevantly includes:

- suggesting that the consumer apply for a particular credit contract with a particular credit provider;

- suggesting that the consumer apply for an increase to the credit limit of a particular credit contract with a particular credit provider;

- suggesting that the consumer remain in a particular credit contract with a particular credit provider;

- assisting the consumer to apply for a particular credit contract with a particular credit provider; and
• assisting the consumer to apply for an increase to the credit limit of a particular credit contract with a particular credit provider.

3.17 Credit contracts are contracts under which credit is or may be provided, being credit to which the National Credit Code applies.\textsuperscript{15} Sections 5 and 6 of the National Credit Code detail the provision of credit to which the National Credit Code applies, and exclude various types of credit contracts. Some exclusions are relevant in the mortgage broker context. For example, the National Credit Code only applies to credit contracts where the debtor is a natural person or strata corporation.

3.18 For the purposes of the new law a mortgage intermediary is either a licensee or a credit representative of a licensee that acts as an intermediary in relation to mortgages. In particular the new law defines a mortgage intermediary as a licensee or a credit representative of a licensee that:

• carries on a business of acting as an intermediary in relation to credit contracts secured by mortgages over residential property; [Schedule 3, items 3 and 4, subsection 5(1) definition of ‘mortgage intermediary’ and paragraphs 15C(1)(a) and 15C(2)(a) of the Credit Act]

• does not perform the obligations, or exercise the rights, of a credit provider in relation to the majority of those credit contracts; and [Schedule 3, items 3 and 4, subsection 5(1) definition of ‘mortgage intermediary’ and paragraphs 15C(1)(b) and 15C(2)(b) of the Credit Act]

• in carrying on the business, acts as an intermediary in relation to credit contracts offered by more than one credit provider. [Schedule 3, item 3 and 4, subsection 5(1) definition of ‘mortgage intermediary’ and paragraphs 15C(1)(c) and 15C(2)(c) of the Credit Act]

3.19 Acting as an intermediary is an existing term defined in section 9 of the Credit Act. Under that section a person is acting as an intermediary where, in the course of their business, the person acts as an intermediary (whether directly or indirectly) between a credit provider and a consumer wholly or partly for the purposes of securing the provision of credit for the consumer under a credit contract.

3.20 The definitions of mortgage broker and mortgage intermediary are intended to only capture those businesses that would ordinarily be described as a mortgage broking or mortgage intermediary businesses. In

\textsuperscript{15} Schedule 1 to the Credit Act contains the National Credit Code. The National Credit Code includes regulations made under the Credit Act for the purposes of the National Credit Code and instruments made under Schedule 1 of the Credit Act: see the definition of National Credit Code in section 5 of the Credit Act.
particular, the definitions of both terms are not intended to extend to credit providers where they are providing credit assistance in relation to their own products rather than providing broking or intermediary services. Similarly, these definitions are not intended to extend to licensees, intermediaries and credit representatives that only provide credit assistance or act as intermediaries in relation to credit contracts offered by a single credit provider. [Schedule 3, item 4, paragraphs 15B(1)(b), 15B(1)(c), 15B(2)(b), 15B(2)(c), 15C(1)(b), 15C(1)(c), 15C(2)(b) and 15C(2)(c) of the Credit Act]

Licensees and credit representatives are liable for the conduct of individual brokers

3.21 The new law also provides that, where a person is authorised as a credit representative of a licensee by a credit representative that is a body corporate, the secondary representative is taken to be acting within the scope of the secondary representative’s actual or apparent authority from the licensee if the secondary representative is acting within the actual or apparent scope of the authority given by the primary representative to engage in specified credit activities on behalf of the licensee. [Schedule 3, item 5, section 158KB of the Credit Act]

The new best interests obligations

3.22 Schedule 3 to the Bill imposes new obligations on mortgage brokers to act in the best interests of consumers. The new obligations apply in relation to licensees that are mortgage brokers, credit representatives that are mortgage brokers, and representatives of credit representatives that are mortgage brokers (all references to mortgage brokers are references to persons to whom the new obligations apply unless indicated otherwise). The obligations are intended to improve outcomes for consumers by legally requiring that mortgage brokers act in their consumer’s best interests and place their consumer’s interests before their own. The new best interests obligations do not affect the existing responsible lending obligations under the Credit Act.

3.23 The obligations apply in relation to credit assistance provided by mortgage brokers in relation to any credit contract. This ensures that when mortgage brokers deal with consumers in relation to mortgages, the broker must act in the best interests of the consumer not only in relation to the mortgage but also in relation to any other credit contracts for which they provide credit assistance. Examples of other credit contracts in relation to which a mortgage broker may provide credit assistance include credit cards and personal loans that are packaged with the mortgage as well as unsecured credit for home renovation. [Schedule 3, item 5, subsection 158L(1) and sections 158LA, 158LD and 158LE of the Credit Act]
3.24 The duty to act in the best interests of the consumer in relation to credit assistance is a principle-based standard of conduct that applies across a range of activities that licensees and representatives engage in.\textsuperscript{16} As such, what conduct satisfies the duty will depend on the individual circumstances in which credit assistance is provided to a consumer in relation to a credit contract. Consistent with the recommendation of the Final Report of the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, the duty does not prescribe conduct that will be taken to satisfy the duty in specific circumstances. It is the responsibility of mortgage brokers to ensure that their conduct meets the standard of ‘acting in the best interests of consumers’ in the relevant circumstances. \textit{[Schedule 3, item 5, section 158KA of the Credit Act]}

3.25 A consumer could be provided with credit assistance by a mortgage broker in a variety of ways. For example, the credit assistance could consist of a broker recommending one or more home loan products out of a selection of home loan products and then assisting the consumer to apply for the product the consumer selects. The content of the duty ultimately depends on the circumstances in which such credit assistance is provided. Examples of steps that may need to be taken are:

- prior to recommending any home loan product or other credit contract to a consumer based on consideration of that consumer’s particular circumstances, the mortgage broker may need to consider a range of products (including the features of those products), form a view about which products are in the consumer’s best interests and then inform the consumer of the range and the options it contains;\textsuperscript{17}

- any recommendations made would be expected to be based on consumer benefits, rather than benefits that may be realised by the broker; that is, a broker should not recommend a loan by prioritising factors that cannot be substantiated as delivering benefits to that particular consumer (such as the broker’s relationship with the lender), over factors and features which affect the cost of the product or are more relevant to the consumer;

- in cases where critical information is not obtained when inquiring about a consumer’s circumstances, the broker could

\textsuperscript{16} The new law also aims to ensure a broad interpretation of what constitutes an ‘act’ for the purposes of the new obligations, and also includes an omission or failure to act in the best interests of a consumer. In particular, the new law clarifies that for the purposes of the new law, a reference to doing an act or thing includes a reference to causing or authorising the act or thing to be done.

\textsuperscript{17} Similar considerations would apply where a mortgage broker suggests that a consumer apply for an increase to the credit limit in a particular credit contract.
be expected to refrain from making a recommendation about a loan where there is a consequent risk that the loan will not be in the consumer’s best interests;

- a broker would not suggest, from their aggregator’s panel of lenders, a white label home loan that has the same features as a branded product from the same lender, but with a higher interest rate, because it would not be in the best interests of the consumer to pay more for an otherwise similar product; and

- during a periodic review, a broker would not suggest that the consumer remain in a credit contract without considering whether this would be in the consumer’s best interests. For example, it may be a breach of the duty if the broker suggested the consumer remain in their current home loan when they could refinance to a cheaper product as the broker did not want to incur the consequent liability to the lender when their commission payments were clawed back.

3.26 Often a mortgage is packaged with one or more other credit contracts as a single product offering. In recommending a package the broker would be expected to ensure that it, rather than the standalone mortgage (if available) or an alternative standalone mortgage or packaged product in the range of options considered by the broker, is in the consumer’s best interests. In making this assessment, the broker would be expected to weigh up the relative benefits and risks for the consumer, which may depend on a range of factors including what the consumer is attempting to achieve and the relative value and importance of the different components of the package. In a package consisting of a home loan and a credit card, for example, the home loan will often be the primary credit contract relevant for determining whether the package is in the consumer’s best interests. A broker should be able to articulate why the particular loan or package they recommend is in the consumer’s best interests – including to the consumer.

3.27 In some situations the consumer will not properly understand the implications of different choices and so the broker may have to assist them to understand why a particular loan is or is not in their best interests. In some cases this assistance may inform any recommendations provided by the broker. Examples of this process are:

- the consumer asks the broker if they should take out an interest-only home loan on a property they are looking to buy. The home loan will have a higher interest rate than a principal and interest home loan. The broker helps the consumer to understand the difference in cost of the two home loans, and other differences in the way in which they
operate, including that the consumer will only build equity if the property’s value increases or they make additional repayments, and the implications of moving to higher repayments at the end of the interest-only period; and

- the consumer asks the broker if they should take out a home loan with an offset account as they have heard this can save them money, even though the interest rate is slightly higher. The broker helps the consumer to understand what is in their best interests, based on the difference between the higher interest rate and the savings that consumer could reasonably expect through utilisation of the offset account.

3.28 In addition to the new best interests obligation, the new law also requires a mortgage broker to resolve conflicts of interests in the consumer’s favour. In particular, if the mortgage broker knows, or reasonably ought to know, that there is a conflict between the interests of the consumer and the interests of the broker or a related party, the mortgage broker must give priority to the consumer’s interests. This requirement is based on section 961J of the Corporations Act, which places an equivalent obligation on financial advisers. [Schedule 3, items 1, 4 and 5, subsection 5(1) definition of ‘associate’ and sections 15A, 158LB and 158LF of the Credit Act]

3.29 The obligation to give priority to the consumer’s interests is not limited to conflicts of interest that mortgage brokers currently know about. Mortgage brokers are expected to take active steps to identify all conflicts of interest covered by section 158LB to minimise the risk of a contravention, including obligations that can arise because of their commercial relationships with third parties. For example, if a mortgage broker has referral arrangements with a real estate agent such that they are an associate, then the broker would need to consider the conflicts that could arise, and ensure that they give priority to the interests of the consumer over their own interests or those of the real estate agent.

3.30 As noted, a mortgage broker may be a licensee or a credit representative. Where the mortgage broker is a credit representative:

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18 These include an associate of the mortgage broker, a representative of the broker, an associate of a representative of the broker and, where the broker is a credit representative of a licensee, also includes any other representative of the licensee and their associates. For the purposes of this obligation, the law defines associate by reference to the definition of associate in subsection 204(2) of the National Credit Code (which includes related bodies corporates, suppliers in respect of whom the credit provider is a linked credit provider, and the officers, agents and employees of the credit provider or any such related body corporate or supplier). The regulations may also prescribe additional circumstances in which a person is an associate of another.
• the obligations only apply where the broker is acting within the scope of the credit representative’s actual or apparent authority from the licensee; and

• the licensee is required to take reasonable steps to ensure that the representative complies with the obligations. [*Schedule 3, item 5, subsection 158L(2), section 158LD and subsection 158LE(2) of the Credit Act*]

3.31 What constitutes reasonable steps will vary from case to case according to the content of the obligation. Failure to take reasonable steps would include a failure to respond to or address identified problems that create a risk of a contravention; that is, licensees will need to act to prevent contraventions of the law, and not simply respond to contraventions once they have happened.

**Conflicted remuneration**

3.32 Schedule 3 to the Bill enables restrictions to be made on conflicted remuneration relating to mortgage broking. In particular, it allows regulations to provide circumstances under which conflicted remuneration can or cannot be given or accepted.

3.33 Conflicted remuneration means any benefit, whether monetary or non-monetary, that is:

• given to a licensee, or a representative of a licensee, who provides credit assistance to consumers that, because of the nature of the benefit or the circumstances in which it is given, could reasonably be expected to influence the credit assistance provided (including, therefore, the choice of credit contract or credit provider or the choice of whether to provide credit assistance or not); or [*Schedule 3, items 3 and 5, subsection 5(1) definition of ‘conflicted remuneration’ and paragraph 158N(a) of the Credit Act*]

• given to a licensee, or a representative of a licensee, who acts as an intermediary and because of the nature of the benefit of the circumstances in which it is given, could be reasonably expected to influence whether or how the licensee or representative acts as an intermediary. [*Schedule 3, items 3 and 5, subsection 5(1) definition of ‘conflicted remuneration’ and paragraph 158N(b) of the Credit Act*]

3.34 This definition of conflicted remuneration is in substance drawn from the definition of conflicted remuneration in Part 7.7A of the Corporations Act.

3.35 The regulations may also prescribe:
• circumstances in which a benefit given to a licensee or representative of a licensee is not conflicted remuneration; and [Schedule 3, items 3 and 5, subsection 5(1) definition of ‘conflicted remuneration’ and paragraph 158NA(b) of the Credit Act]

• circumstances in which a benefit given to a licensee or a representative of a licensee is conflicted remuneration. [Schedule 3, items 3 and 5, definition of ‘conflicted remuneration’ and paragraph 158NA(a) of the Credit Act]

3.36 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.

3.37 Regulations also give effect to the ban on conflicted remuneration. This provides flexibility to provide for the circumstances in which conflicted remuneration is banned.

3.38 The ban has two aspects: a prohibition on accepting conflicted remuneration and a prohibition on giving conflicted remuneration. In particular, in relation to accepting conflicted remuneration:

• a licensee must not accept conflicted remuneration in circumstances prescribed by the regulations if the licensee is a mortgage broker or mortgage intermediary; and [Schedule 3, item 5, section 158NB of the Credit Act]

• a credit representative of a licensee must not accept conflicted remuneration in circumstances prescribed by the regulations, if the credit representative or the licensee is a mortgage broker or mortgage intermediary. The licensee must also take reasonable steps to ensure that its credit representative complies with this requirement. [Schedule 3, item 5, section 158NC of the Credit Act]

3.39 Under the existing sections 324 and 325 of the Credit Act, a licensee or credit representative will also be liable for the conduct of its agents, employees and other persons acting at the direction or with the consent or agreement (whether express or implied) of an official of the licensee. This means that if an employee or representative of a licensee who is a mortgage broker accepts conflicted remuneration in circumstances prescribed by the regulations, the licensee may be liable for breach of these provisions.

3.40 In relation to giving conflicted remuneration:

• an employer of either a licensee or a representative must not give the licensee or representative conflicted remuneration in circumstances prescribed by the regulations if the licensee or representative is a mortgage broker or mortgage intermediary; [Schedule 3, item 5, section 158ND of the Credit Act]
• a credit provider must not give a licensee or representative conflicted remuneration in circumstances prescribed by the regulations if the licensee or representative is a mortgage broker or mortgage intermediary; and [Schedule 3, item 5, section 158NE of the Credit Act]

• a mortgage intermediary must not give a licensee or representative conflicted remuneration in circumstances prescribed by the regulations if the licensee or representative is a mortgage broker or mortgage intermediary. [Schedule 3, item 5, section 158NF of the Credit Act]

Anti-avoidance

3.41 Schedule 3 to the Bill includes a prohibition on schemes to avoid the obligations imposed under this Schedule in new Part 3-5A of the Credit Act. In particular, a person must not, either alone or with other persons, begin to carry out or carry out a scheme if:

• it would be concluded that they did so for the sole purpose or for a purpose (that is not incidental) of avoiding the obligations. This is an objective test that requires an objective conclusion as to purpose to be reached having regard to objective facts. This test does not require the analysis or determination of the actual subjective purpose of any relevant person; and

• the scheme or a part of the scheme has or would achieve that purpose (but for the prohibition). [Schedule 3, item 5, section 158T of the Credit Act]

3.42 The prohibition is necessary to support the effective operation of the obligations in the Schedule. It is based on anti-avoidance provisions that apply in relation to financial advice obligations in Part 7.7A of the Corporations Act 2001.19

Civil penalties

3.43 A contravention of each obligation in Schedule 3 to the Bill is a civil penalty. The maximum penalties applicable to each obligation are detailed in the following table.

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19 See Division 6 of that Part.
Table 3.1 Penalties concerning obligations

<table>
<thead>
<tr>
<th>Obligation</th>
<th>Penalty</th>
</tr>
</thead>
<tbody>
<tr>
<td>Failure of a licensee to act in the best interests of the consumer</td>
<td>5,000 penalty units</td>
</tr>
<tr>
<td>Failure of a licensee to give priority to the consumer’s interests</td>
<td>5,000 penalty units</td>
</tr>
<tr>
<td>Failure of a credit representative to act in the best interests of the consumer</td>
<td>5,000 penalty units</td>
</tr>
<tr>
<td>Failure of a licensee to take reasonable steps to ensure that the credit representative acts in the best interests of the consumer</td>
<td>5,000 penalty units</td>
</tr>
<tr>
<td>Failure of a credit representative to give priority to the consumer’s interests</td>
<td>5,000 penalty units</td>
</tr>
<tr>
<td>Failure of a licensee to take reasonable steps to ensure that credit representatives give priority to the consumer’s interests</td>
<td>5,000 penalty units</td>
</tr>
<tr>
<td>Licensee accepting conflicted remuneration</td>
<td>5,000 penalty units</td>
</tr>
<tr>
<td>Credit representative accepting conflicted remuneration</td>
<td>5,000 penalty units</td>
</tr>
<tr>
<td>Failure of licensee to take reasonable steps to ensure that credit representatives do not accept conflicted remuneration</td>
<td>5,000 penalty units</td>
</tr>
<tr>
<td>Employer of licensee giving licensee conflicted remuneration</td>
<td>5,000 penalty units</td>
</tr>
<tr>
<td>Employer of licensee giving representative conflicted remuneration</td>
<td>5,000 penalty units</td>
</tr>
<tr>
<td>Credit provider giving licensee conflicted remuneration</td>
<td>5,000 penalty units</td>
</tr>
<tr>
<td>Credit provider giving representative conflicted remuneration</td>
<td>5,000 penalty units</td>
</tr>
<tr>
<td>Mortgage intermediary giving licensee conflicted remuneration</td>
<td>5,000 penalty units</td>
</tr>
<tr>
<td>Mortgage intermediary giving representative conflicted remuneration</td>
<td>5,000 penalty units</td>
</tr>
<tr>
<td>Engaging in avoidance scheme</td>
<td>5,000 penalty units</td>
</tr>
</tbody>
</table>

3.44 The existing enforcement regime in the Credit Act also applies in relation to contravention of the obligations. For example, the ability of
courts to provide a range of remedies under Part 4-2 of Chapter 4 of the Credit Act, including injunctions, compensation orders, and other orders, could apply to contraventions of the above obligations.

Consequential amendments

3.45 Schedule 3 to the Bill makes a number of consequential amendments that ensure that all provisions of the Credit Act that currently apply in relation to ‘commissions’ also apply in relation to ‘conflicted remuneration’. The affected provisions generally relate to information that must be disclosed to consumers in particular circumstances or the conditions that must be met if certain words such as “independent”, “impartial” or “unbiased” are to be used in connection with a credit service. [Schedule 3, item 2 and items 7 to 29 subsection 5(1) (definitions of ‘commission’ and ‘indirect remuneration’), paragraph 92(e), section 111, subparagraphs 113(2)(g)(i), 113(2)(g)(ii), 113(3)(b)(i) and 113(3)(b)(ii), Division 5 of Part 3-1 of Chapter 3 (heading), Section 121 (heading), paragraphs 121(2)(b), 121(3)(a) and 121(3)(b), section 134, subparagraphs 136(2)(g)(i), 136(2)(g)(ii), 136(3)(b)(i) and 136(3)(b)(ii), Division 5 of Part 3-3 of Chapter 3 (heading), section 144 (heading), paragraph 144(2)(b), 144(3)(a) 144(3)(b), subparagraphs 158(2)(g)(i), 158(2)(g)(ii), 158(3)(b)(i) 158(3)(b)(ii), and 160B(2)(a)(i), and paragraph 160B(2)(d) of the Credit Act]

Application and transitional provisions

3.46 Application provisions apply in relation to both the new best interests obligations and the ban on conflicted remuneration. In particular, the Bill amends the National Consumer Credit Protection (Transitional and Consequential Provisions) Act 2009 to provide for the following arrangements:

- the obligations relating to the best interests obligations apply in relation to the provision of credit assistance to a consumer after 1 July 2020, whether or not the assistance was sought, or commenced being provided before that day; and [Schedule 3, item 6, items 1 and 2 of Schedule 10 to the National Consumer Credit Protection (Transitional and Consequential Provisions) Act 2009]

- the obligations relating to the ban on conflicted remuneration apply in relation to conflicted remuneration given on or after 1 July 2020 if the benefit is given under an arrangement entered into on or after 1 July 2020, subject to regulations being made prescribing the circumstances in which the ban applies. [Schedule 3, item 6, items 1 and 3 of Schedule 10 to the National Consumer Credit Protection (Transitional and Consequential Provisions) Act 2009]
Chapter 4
Statement of Compatibility with Human Rights

Prepared in accordance with Part 3 of the Human Rights (Parliamentary Scrutiny) Act 2011

Implementing Recommendation 4.7 of the Financial Services Royal Commission

4.1 Schedule 1 to the Bill is compatible with the human rights and freedoms recognised or declared in the international instruments listed in section 3 of the Human Rights (Parliamentary Scrutiny) Act 2011.

Overview

4.2 Schedule 1 to the Bill extends unfair contract terms regime in the Australian Securities and Investments Commission Act 2001 to apply to insurance contracts under the Insurance Contracts Act 1984.

Human rights implications

4.3 Schedule 1 to the Bill does not engage any of the applicable rights or freedoms.

Conclusion

4.4 Schedule 1 to the Bill is compatible with human rights as it does not raise any human rights issues.

Implementing Recommendation 4.2 of the Financial Services Royal Commission

4.5 Schedule 2 to the Bill is compatible with the human rights and freedoms recognised or declared in the international instruments listed in section 3 of the Human Rights (Parliamentary Scrutiny) Act 2011.

Overview

4.6 Schedule 2 to the Bill gives effect to recommendation 4.2 of the Financial Services Royal Commission to ensure that the consumer protection provisions of the Australian Securities and Investments Commission Act 2001 apply to funeral expenses policies.
Human rights implications

4.7 Schedule 2 to the Bill does not engage any of the applicable rights or freedoms.

Conclusion

4.8 Schedule 2 to the Bill is compatible with human rights as it does not raise any human rights issues.

Mortgage brokers

4.9 Schedule 3 to the Bill is compatible with the human rights and freedoms recognised or declared in the international instruments listed in section 3 of the Human Rights (Parliamentary Scrutiny) Act 2011.

Overview

4.10 Schedule 3 to the Bill amends the Credit Act to require mortgage brokers to act in the best interests of consumers and to address conflicted remuneration for mortgage brokers and mortgage intermediaries such as aggregators. These new laws improve consumer outcomes by requiring brokers to act in the best interests of their clients and by reducing the potential for conflicts of interests to arise which may impact the advice consumers receive from brokers.

4.11 The key features of the new law are:

• mortgage brokers must act in the best interests of consumers in relation to credit assistance in relation to credit contracts;
• where there is a conflict of interest, mortgage brokers must give priority to consumers in providing credit assistance in relation to credit contracts;
• mortgage brokers and mortgage intermediaries must not accept conflicted remuneration;
• employers, credit providers and mortgage intermediaries must not give conflicted remuneration to mortgage brokers or mortgage intermediaries; and
• the circumstances in which these bans on conflicted remuneration apply are to be set out in the regulations.

Human rights implications

4.12 Schedule 3 to the Bill does not engage any of the applicable rights or freedoms.
Conclusion

4.13 Schedule 3 to the Bill is compatible with human rights as it does not raise any human rights issues.