

# Insurance Update

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## Valuers and mortgage brokers: – new Federal regulation of the industry due in November 2009

by Linda Hamilton, Partner, Notary Public

The *National Consumer Credit Protection Bill 2009* is currently before the Commonwealth Parliament. This legislation, if passed, will have a significant effect on the conduct of mortgage brokers. It will also have a direct effect on valuers by diluting the number and size of claims against them arising from credit transactions.

### Transition Requirements

Transitional provisions are the first element of the new regulatory regime to come into force. These requirements provide a gradual introduction to the full licencing scheme. From the 1st of January 2010 individuals who engage in a credit activity will be required to hold a licence or be registered with ASIC. This means that people who provide assistance to clients in sourcing credit products or who act as intermediaries will need to be licenced. Mortgage brokers will need to be licenced. Failure to be registered or hold a licence can result in civil and criminal sanctions.

The requirement for full licencing takes effect from the 1st of July 2011. It is unlikely that a valuer would be required to be registered or licenced under this legislation because the activities of valuing do not fall under the definition of credit activities.

### Chapter 2: Licencing of persons who engage in credit activities

Chapter 2 of the Bill contains the licencing regime and provides civil and criminal sanctions for engaging in credit activities without a licence. A defence to failing to hold a licence is engaging in credit activities on behalf of a licenced principal, which will generally be as a credit representative. Licencees are required to lodge annual compliance certificates with ASIC and a failure to do so will result in significant civil penalties. Licenced individuals are prohibited from engaging in credit activities with a person who is required to hold a licence who does not.

This chapter also has an explicit prohibition to providing misleading information. This provision will be contravened if the information is provided knowingly or recklessly.

The chapter spells out multiple obligations for licencees. The most onerous are the requirements for dispute resolution and professional indemnity insurance.

- Licencees will require an internal dispute resolution procedure. This procedure must comply with Australian Standard for Complaints Handling and other matters ASIC considers relevant.
- Licencees will also have to be a member of an external dispute resolution scheme. These schemes will need to be approved by ASIC. It is likely that ASIC will publish a list of approved schemes.
- Licencees are required to hold professional indemnity insurance. This insurance must be adequate and based on the size of the licencees' business. The basic requirement will be that the insurance will provide cover for the maximum liability which may arise.

Licencees are able to appoint credit representatives under their licence, which will allow a broking business to operate under a single licence. These appointments must be in writing and notified to ASIC.

Credit representatives will be provided with a credit representative number by ASIC. The activities which the representative is allowed under the licence must be specified in the notice authorising them to act as credit representatives and the notice to ASIC.

The licencee is responsible for the conduct of the representative when the representative's conduct is within the authority of the licence.

It is also a requirement for licencees to keep financial records. Failure to keep adequate financial records may result in civil and criminal sanctions. Financial records appear to be restricted to documents of prime entry and trust account information.

## Chapter 3: Responsible lending conduct

Chapter 3 will be the most important governing the conduct of mortgage brokers. It applies to the conduct of credit assistance providers, amongst others.

The first major requirement of this chapter is that brokers, like all credit assistance providers, will be required to provide to their clients a credit guide as soon as they know the provider is likely to provide credit assistance. A licensee's credit guide will contain information for the benefit of the client including:

- the credit assistance provider's details, including name, contact details, licence number;
- information about fees, charges and commissions and their calculation methods;
- information as to 6 of the provider's credit providers;
- information about external dispute resolution schemes and external compensation arrangements the licensee has in place; and
- information about the licensee's obligations under the Act, particularly, the requirements to make an assessment whether the credit contract is unsuitable and to provide the client with that assessment, and not to assist or suggest unsuitable contracts to clients.

A credit representative's credit guide will be substantially similar. It will contain:

- the representative's name, contact details and credit representative number;
- information about fees and charges and their calculation methods;
- information about the licensees for whom the credit representative acts; and
- information about fees, charges and commissions.

Licensees must provide a quote prior to providing credit assistance. This quote must spell out the maximum amount the client will pay and include information on fees and charges. Licensees are prohibited from requesting more money than the maximum spelt out under the quote. This provision does not apply to credit representatives, however, considering that a representative must be operating under a licensee, it probably shifts the requirement onto the licensee. Therefore a licensee will be required to provide this quote for all their credit representatives.

Licensees must also provide a preliminary assessment of the unsuitability of the credit contract before suggesting any course of action on a credit contract. The licensee must assess whether the contract will be unsuitable for the client. Reasonable enquiries must be made about the client's requirements, objectives and financial situation. The licensee must also take reasonable steps to verify the client's financial situation. This creates an onus on the broker to make its own independent enquiries.

The legislation also spells out when a credit contract must be assessed as unsuitable. This is when the client will be unable to comply with the financial obligations or could only comply with substantial financial hardship, or the contract does not meet the client's requirements and objectives. It should also be noted that if the client requests this assessment a licensee will be required to provide it to them.

## Chapter 4: Remedies

Chapter 4 generally allows for ASIC and other regulatory bodies to take action against individuals who contravene the legislation. However, this chapter also provides for courts to compensate clients who suffer loss or damage as a result of a contravention of the Act or an offence under the Act.

For this provision to apply the client must have suffered loss or damage from a contravention or offence under the Act. This provision would apply to licensees and their representatives as well as individuals who contravene the Act by not possessing a licence when required.

ASIC or a wronged client may apply for relief under this provision.

Consumers are also provided further protection from loss from the courts. If a contravention of a civil penalty occurs and a client suffers or is likely to suffer loss as a result, the court is empowered to compensate the client or prevent the loss or damage occurring to the client. The Act doesn't limit the way in which a court could do this, however, it does list options including:

- declaring a credit arrangement void, possibly from the time it was entered into;
- varying an arrangement as the court thinks fit, possibly from the time the arrangement was entered into;
- refusing to enforce terms of an agreement; and
- requiring the contravener to compensate the client or provide services to the client at the contravener's request.

## Schedule 1: National Credit Code

The National Credit Code outlined in the Bill will apply more to the credit provider than to the intermediary. However, there are some provisions which could trip up a mortgage broker.

The Code only applies to the provision of credit when the credit is provided wholly or predominantly for personal, domestic or household purposes, or for the purchase, renovation or improvement of residential property for investment purposes; or for refinancing of those purposes, and a charge is, or may be made, for providing the credit.

The Code will be presumed to apply unless the contrary is established. This means that it will be the onus of the credit provider to prove that this Code does not apply rather than on the borrower to prove it is applicable. The Code will not be applicable if the purpose of the credit is not a Code purpose.

Importantly, the purchase of residential property even when for investment purposes, will be caught by the Code and this is a big change from the current position in New South Wales.

A lender still may have a borrower declare that the purpose of the credit is not a Code purpose. However, this declaration will be ineffective if, when the declaration was made, the credit provider or other relevant person knew or had reason to believe, or would have known or had reason to believe if they made reasonable enquiries, that the credit was in fact to be applied wholly or predominantly for one of those purposes. Inducing a debtor to make a false declaration under this section is a strict liability criminal offence. This is a significant change.

Mortgage brokers will need to consider the provisions regarding the negotiating and making of the credit contract. Credit contracts must be in writing and the Code stipulates certain requirements including:

- the details of the credit provider and the amount of credit;
- interest rates, the methods of calculating interest, the total interest payable if ascertainable and any changes affecting interest rates;
- repayment amounts and frequency;
- fees, charges and commissions and changes affecting the fees and charges; and
- the consequences of default including enforcement expenses and default rates of interest.

If a contract does not comply with these requirements it will be in breach of the Code along with being a criminal offence. This will allow the customer to recover through the courts from the individual who caused the breach. The client would also be able to have parts of the contract rewritten by the courts.

## Advertising

Mortgage brokers who advertise may also be required to comply with the provisions of Part 9 of the Code. Failure to comply with this section is a criminal offence. Advertisements that contain annual percentage rates must include the level of fees and charges payable. There are also prohibitions against false and misleading advertising.

## The legislation will regulate a broker's activities

The primary impact of this legislation will be the regulation of brokers' business activities. The requirement to assess whether a credit product meets the requirements of a borrower has the potential to create a significant area of liability. Failure to undertake this assessment or declaring a product satisfactory when it does not meet the requirements of the Act will have a civil penalty. These actions will expose the broker to the remedies under the Act, including allowing the client to recover compensation from the broker, and opening up the potential for the court to rewrite or cancel the contract.

Brokers will also face potential liability for failure to comply with certain other regulations. Failure to provide 'credit guides', failure to quote prior to providing assistance, conducting business with people who should be licenced and are not, can all amount to sanctions and action from clients to recover.

Brokers will be required to comply with licencing requirements. These requirements generally possess at least civil sanction, and usually criminal repercussions. It is also likely that if a client suffers a loss as a result of a failure of a broker to comply with the licencing requirements the client could recover from the broker. Licencees will also be responsible for the actions of their credit representatives. This will potentially make them liable along with their credit representative, for their representative's actions.

We expect there will be some feedback in relation to this Bill and there may be further amendments. It represents to mortgage brokers, a considerable change in their operating environment. It brings regulation nationally and hence, creates a need for compliance measures and mechanisms to be put into place. One of these measures will be the requirement for adequate professional indemnity insurance.

We anticipate that this may include mandatory terms and sums insured that are sufficient to risk-manage the loan portfolio of each broker. This alone will be a substantive shift for many mortgage brokers, who to date may have managed on minimum premiums, limited to no reinstatements and very low sums insured.

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