SPECIALIST FINANCE GROUP

RESPONSE & RECOMMENDATIONS TO THE SEDGWICK REPORT

DATED 19 APRIL 2017

Australian Credit Licence No. 387025

INTRODUCTION

Specialist Finance Group (formerly Specialist Mortgage) commenced as an aggregator in 1991. Over the last 25 years in finance aggregation Specialist Finance Group has been at the forefront of changes within our industry commencing with being an active participant in Western Australia becoming the first state to have all Mortgage Brokers licenced.

We operate from our head office in Perth with offices in Sydney, Melbourne, Singapore, Dubai, Hong Kong and London.

Currently Specialist Finance Group has Funds Under Management of $18 Billion from in excess of 60 Lenders.

These Funds Under Management represent in excess of 60,000 active loans.

$18,000,000,000 IN FUNDS UNDER MANAGEMENT

60,000+ ACTIVE LOANS

450+ MORTGAGE BROKERS

60+ LENDER RELATIONSHIPS

REVIEW OF REMUNERATION OF AGGREGATORS AND MORTGAGE BROKERS

It is acknowledged that the Sedgwick Report was commissioned on behalf of the Australian Banking Association of which there are 13 member Banks.

The above report was released to our industry in April this year.

Whilst Specialist Finance Group welcomes good and practical reform within our industry we believe that there are a number of recommendations within this report that unfairly target the third party industry and in particular the roles and income of Mortgage Brokers.

Specialist Finance Group fully supports Recommendation 16 of the report but have serious concerns with regards to Recommendation 17 and 18 of this report.

Recommendation 17 suggests a holistic approach broadly equivalent to that proposed for the performance management of equivalent retail Bank staff.

This, we believe clearly does not recognise the substantial difference between retail Bank staff and Mortgage Brokers.

Retail Bank staff are generally employees of the Bank and can only recommend and sell their own finance products for their employer being a nominated Bank.

The core value proposition of a Mortgage Broker is that they are able to provide a significantly broader level of finance products to the consumer as they assess their client's requirements across a range of financial institutions and not solely one Bank.

Recommendation 18 suggests Banks adopt approaches to the remuneration of Aggregators and Mortgage Brokers that do not directly link payments to loan size and reflects a holistic approach to performance management.

Whilst we acknowledge that this is currently a recommendation only, we again feel that in part this undervalues the role of a Mortgage Broker.

The Mortgage Broker assesses their client's requirements, which includes the loan amount and makes the application to the chosen Bank, from this point on it is at the Bank's sole discretion as to whether the loan is approved or declined on the merits provided.

Our industry fully supports performance management between Mortgage Brokers and their clients but any performance management needs to be carefully addressed and not be at the sole interpretation by the Banks only.

It is also important to note that the ASIC report does not recommend removing the link between loan size and commission, nor fee for service, nor removal of trail commission.

Whilst we acknowledge the role that the Australian Banking Association plays within our industry It is our view that the Australian Banking Association's role on this matter is one that cannot be both truly impartial and independent.

The financial services industry has greatly improved under the national regulations of ASIC and as stated above we fully support regulations in our industry but ones which do not unfairly target a select player within the industry being Mortgage Brokers.

Any recommendations implemented by the Banks from this report should only be implemented after detailed input and consultation from the third party channel and where common sense will prevail for all parties including Mortgage Brokers.

The third party channel provides a substantial benefit to the financial services industry and in particular the services Mortgage Brokers provide to their clients which at all times needs to be recognised, respected and valued.

THE IMPORTANCE OF THE BROKER CHANNEL/THIRD PARTY

REFER: ASIC REPORT 516 REVIEW OF MORTGAGE BROKER REMUNERATION

- Brokers play a very important role in the home loan market. They are responsible for arranging around half of all home loans in Australia. Consumers are increasingly turning to brokers to get help in obtaining a home loan—in 2012 brokers arranged 47.7% of home loans for the lenders in our review. In 2015, this increased to 54.3%.
- Brokers arranged almost 520,000 new home loans from the lenders in our review in 2015 (compared to 340,000 in 2012).
- Brokers can play an important role in promoting good consumer outcomes and strong competition in the home loan market.
- From a consumer outcomes perspective, in a well-performing market brokers can help:
  - match the needs of the consumer with the right home loan product and lender;
  - navigate the home loan application process, which can be daunting for many consumers; and
  - improve consumer understanding of home loans and financial literacy.
- From a competition perspective, brokers have the potential to:
  - play a valuable role in providing a distribution channel for lenders— especially smaller lenders—without their own distribution network (e.g. branches);
  - exert downward pressure on home loan pricing, by forcing lenders to compete more strongly with each other for business.
- Remuneration and ownership structures can, however, inhibit the consumer and competition benefits that can be achieved by brokers. In setting out our findings, we have made a number of proposals to improve consumer outcomes and competition: see paragraph 112. These proposals should strengthen the positive contribution that brokers provide in this sector. Some of the proposals also aim to improve the operation of the home loan market more generally.
- We also consider that our proposals will improve the trust and confidence that consumers can have in brokers.

BROKERS PLAY A CRITICAL ROLE IN THE HOME LOAN MARKET

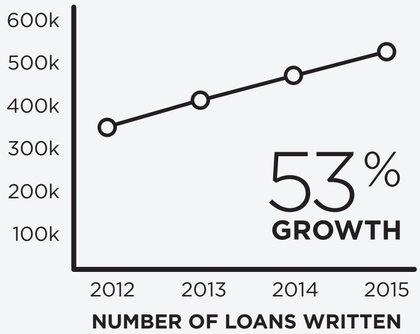
REFER: ASIC REPORT 516 REVIEW OF MORTGAGE BROKER REMUNERATION

IN 2015...

520,000
LOANS WRITTEN

$545 BILLION
IN OUTSTANDING LOANS

54.3% of home loans sold
WENT THROUGH A BROKER



RECOMMENDATION 17 OF THE SEDGWICK REPORT

This Recommendation states the following:

Banks adopt, through negotiation with their commercial partners, an ‘end to end’ approach to the governance of Mortgage Brokers that approximates as closely as possible to holistic approach broadly equivalent to that proposed for the performance management of equivalent retail Bank staff.

This, we believe clearly does not recognise the substantial difference between retail Bank staff and Mortgage Brokers.

Retail Bank staff are generally employees of the Bank and can only recommend and sell their own finance products for their employer being a nominated Bank.

A retail Bank staff member will not advise a consumer of better and more suitable finance products available for a consumer that is on offer or available by an alternative lender other than themselves.

The core value proposition of a Mortgage Broker is that they are able to provide a significantly broader level of finance products to the consumer as they assess their client’s requirements across a range of financial institutions and not solely one lender.

Mortgage Brokers also have a higher level of one on one customer service with their client and in most cases their client deals exclusively with their Mortgage Broker throughout their engagement.

This is not the same when a consumer deals directly with a retail Bank staff member as the consumer is also dealing with the Bank and on many occasions when dealing directly with the Bank they will deal with a number of staff within the Bank.

This more direct relationship between a Mortgage Broker and their client is one of the largest reasons why consumers are accessing their loan products through Mortgage Brokers.

Mortgage Brokers are also independently licenced by the governing body ASIC and in addition Mortgage Brokers are also held accountable by other industry bodies including aggregators, lenders and associations such as MFAA and FBAA.

Mortgage Brokers who hold an Australian Credit Licence with ASIC are required to complete the process for an Annual Compliance Certificate (CL50).

Mortgage Brokers must go through a detailed NCCP process as detailed further in this submission which includes Privacy Statement, Credit Guide, Fact Find (client needs analysis), Quote if applicable, Preliminary Assessment, Credit Proposal Disclosure, all before the finance application is signed by the consumer.

Retail Bank staff do not follow the same extensive process, as most lenders when dealing with their customers proceed straight to a finance application form.

Mortgage Brokers in most cases are self employed contractors liable for their own business costs unlike employees of lenders therefore their remuneration received via any lender is a gross remuneration and does not reflect Mortgage Brokers costs in running their business and providing their services.

Mortgage Brokers also provide greater flexibility with availability than retail Bank staff as they are able to meet with consumers not only during business hours but also after hours, weekends and public holidays.

Mortgage Brokers also provide their clients direct contact access that includes their mobile contact number and email address.

Retail Bank staff generally do not provide a consumer the same level of direct contact details and in most cases when a consumer is dealing with a retail Bank a large number of their queries are dealt with via the Bank's central administration process.

Mortgage Brokers are also required to continue professional development training on a yearly basis which deals with the Mortgage Broking industry as a whole unlike employees of a particular lender who whilst they are required to carry out continual professional development a large part of their development training is in line with their employers direction.

Mortgage Brokers are also required to hold membership with External Disputes Resolutions which deals with any complaints made by consumers.

Mortgage Brokers are also required to hold valid and current Professional Indemnity Insurance whilst engaging in any finance broking activity and are also required to have a run off clause of not less than 84 months after ceasing being a Mortgage Broker.

The Mortgage Broker is professionally liable for any claim made against them by the consumer or any other third party whereby employees of Banks are not held liable.

Employees of Banks are not required to hold Professional Indemnity Insurance.

Specialist Finance Group for the reasons stated above believe that there is a clear and substantial difference between the operations of a retail Bank staff member and that of the operations of a Mortgage Broker and should be both recognised and treated differently.

RECOMMENDATION 18 OF THE SEDGWICK REPORT

This Recommendation states the following:

Banks adopt approaches to the remuneration of Aggregators and Mortgage Brokers that do not directly link payments to loan size and reflects a holistic approach to performance management (see Recommendation 17):

a. **To establish in a timely fashion how best to address Recommendations 17 and 18, Banks with a significant recourse to the Mortgage Broker channel, but at least the four major Banks, each report regularly to ASIC on their progress; and**

b. **With enhanced oversight by ASIC (and other regulators as necessary) to monitor market responses**

Specialist Finance Group does not agree that with linking Mortgage Brokers remuneration to either Loan Size or Loan to Valuation Ratio (LVR).

Mortgage Brokers in providing their services and making their finance recommendation to the consumer, do not have any decision making authority or discretions to any loan approvals as it is the sole decision of the lender as to whether or not the lender will accept and/or approve the finance application submitted.

With loans that have a higher LVR the Mortgage Broker, in most cases, is required to carry out additional work and research on behalf of their client being the consumer and the Mortgage Broker should not be penalised in a reduction of their remuneration as it is the lender's sole choice to accept and approve the loan as presented.

It is also noted that ultimately it is the lenders who approve all finance applications and any loan amounts in any application need to be substantiated and agreed to by the lender when obtaining the loan approval.

It is unfair to Mortgage Brokers and to the Third Party channel that the inference to Mortgage Brokers loans being larger than retail Bank staff is a negative one, where it is in fact the lenders themselves that vet the Mortgage Brokers application to them and approve it on the merits provided.

Specialist Finance Group highlights in this written submission the very detailed process that the Mortgage Brokers go through with their clients and that all steps throughout this process the consumer can exercise their sole discretion as to whether or not they wish to continue with the process of using a Mortgage Broker.

The consumer when going through this process with a Mortgage Broker has clearly decided that the best service and outcome for them can be obtained by using the Mortgage Broker as opposed to dealing directly with only one lender.

Specialist Finance Group also refers to point 439 of the ASIC Review of Mortgage Broker Remuneration which in part states the following:

Based on the data we received, we did not identify trail commissions directly leading to poor consumer outcomes.

Specialist Finance Group also makes the point that in our 25 years of providing aggregation services we have never received a complaint from any consumer or lender in relation to a consumer being provided or coerced into a higher loan amount that the consumer had not requested.

Specialist Finance Group for the reasons stated above does not agree that with linking Mortgage Brokers remuneration to either loan size or Loan to Valuation Ratio (LVR).

CONSUMERS CHOICE

The Sedgwick Report in part centres around transparency and achieving the best outcome for any consumer.

Specialist Finance Group and our industry as a whole fully supports this view however we believe the Sedgwick Report does not truly reflect not only the important service that Mortgage Brokers provide any consumer but does not recognise the relationship and the process that all consumers receive which includes their freedom of choice.

When a consumer considers any finance application, they start with the initial choice of either approaching a lender directly or dealing through a Mortgage Broker.

- In the consumer making their choice and selecting a Mortgage Broker the Mortgage Broker will then ascertain the consumers requirements.

THE CONSUMER HAS THE CHOICE TO PROCEED OR NOT PROCEED WITH THEIR DEALINGS WITH THE MORTGAGE BROKER

- The Mortgage Broker completes a Privacy Statement that allows them to complete all necessary credit assessment checks such as Veda reports. This Privacy Statement also allows the Mortgage Broker to reasonably engage other third parties on behalf of the consumer. This document is acknowledged and signed by the consumer.

THE CONSUMER HAS THE CHOICE TO PROCEED OR NOT PROCEED WITH THEIR DEALINGS WITH THE MORTGAGE BROKER

- The Mortgage Broker then provides the consumer with a Credit Guide which discloses all broker information including the Mortgage Brokers licence details, internal complaints officer and external dispute resolutions and also provides a minimum requirement of 6 most commonly used lenders by the Mortgage Broker. This document is acknowledged and signed by the consumer.

THE CONSUMER HAS THE CHOICE TO PROCEED OR NOT PROCEED WITH THEIR DEALINGS WITH THE MORTGAGE BROKER

- The Mortgage Broker completes a Fact Find and Client Needs Analysis to determine the following:

  - Getting to know their client, their goals and objectives
  - Collecting information about their client
  - Analysing their borrowing capacity and lender options
  - How to protect new / existing assets, they and their family may have
  - Next steps to proceed
  - Reasons for seeking Mortgage Finance Advice
  - Short Term (1-5 years)
  - Medium Term (6-15 years)
  - Long Term (15-30 years)

  This information contains the full financial position of the consumer, which then allows the Mortgage Broker the ability to review the information provided and make recommendations as to the suitable products that the consumer may be eligible for and meets their finance requirements.

THE CONSUMER HAS THE CHOICE TO PROCEED OR NOT PROCEED WITH THEIR DEALINGS WITH THE MORTGAGE BROKER

- The Mortgage Broker then provides the consumer a Credit Quote if the Mortgage Broker intends to charge the consumer a fee. This document is acknowledged and signed by the consumer.

THE CONSUMER HAS THE CHOICE TO PROCEED OR NOT PROCEED WITH THEIR DEALINGS WITH THE MORTGAGE BROKER

- The Mortgage Broker then completes a Preliminary Assessment which details the loan recommendations by the Mortgage Broker which is then both discussed and explained to the consumer. This document is acknowledged and signed by the consumer.

THE CONSUMER HAS THE CHOICE TO PROCEED OR NOT PROCEED WITH THEIR DEALINGS WITH THE MORTGAGE BROKER

- The consumer in continuing to engage a Mortgage Broker will be presented with a Credit Proposal and Appointment to Act which not only again provides relevant Mortgage Broker details but also provides detailed information on the following:

  - Fees payable by the consumer
  - How Mortgage Brokers are paid
  - Other Fees/Benefits the Mortgage Broker may be entitled to be paid
  - Reasonable estimate of commissions
  - External parties sharing in remuneration
  - Estimate of fees and charges applicable and payable by the consumer on their loan
  - Security and/or securities to be provided by the consumer

  This document is acknowledged and signed by the consumer.

- It is after the above process that a finance application for the preferred lender is completed and lodged directly to the chosen lender for consideration.

THE CONSUMER HAS THE CHOICE TO PROCEED OR NOT PROCEED WITH THEIR DEALINGS WITH THE MORTGAGE BROKER

- In the event that the finance application is approved and in the process of signing loan documents the lender will again detail all information about the loan including commissions payable to the Mortgage Broker and other third parties.

The above process clearly demonstrates the comprehensive process and relationship the Mortgage Broker has with a consumer. This process not only provides full disclosure and transparency between the Mortgage Broker and the consumer it also provides the consumer the clear choice on whether to continue their relationship with the Mortgage Broker on multiple levels including knowing the full transparent details about the remuneration the Mortgage Broker will receive in providing their services.

SPECIALIST FINANCE GROUP

NCCP Client Documents Process Flow

NO DOCUMENT SHOULD PRE-DATE THE PRIOR DOCUMENT

PRIVACY STATEMENT	CREDIT GUIDE	FACT FIND Client Needs Analysis (CNA)	QUOTE (If Applicable)	PRELIMINARY ASSESSMENT (PA)	CREDIT PROPOSAL DISCLOSURE	HOME LOAN APPLICATION SIGNED
Provide Privacy Statement to client – record how & when issued on checklist	Provide Credit Guide to client – record how & when issued on checklist	Complete your Fact Find (Client Needs Analysis) & obtain and record financial verification	If you intend to charge a Fee, complete & sign Quote prior to providing advice / assistance – provide copy to client	Generate Preliminary Assessment (PA) = discuss recommendations & have client sign PA	Once client confirmed lender, prepare Credit Proposal Disclosure & provide with Loan Application	**HOME LOAN APPLICATION SIGNED** (OK to be emailed to be signed with 2 prior documents)

If the loan amount increases, or lender or product changes, then go back to FACT FIND and start again.

RECOMMENDATIONS IN RESPECT TO REMUNERATION OF MORTGAGE BROKERS & ADDITIONAL GOVERNANCE

Specialist Finance Group supports the following recommendations:

- Banks cease the practice of providing volume based incentives that are additional to upfront and trail commissions.
- Banks cease non-transparent soft dollar payments in favour of more transparent methods to support training etc.
- Banks cease the practice of increasing the incentives payable to brokers when engaging in sales campaigns.
- Mortgage Brokers maintain an agreed minimum number of lender accreditations.
- Mortgage Brokers provide their clients at their initial meeting a list of all lender accreditations the Mortgage Broker is accredited with and not solely who they may have access to via their aggregator. This would advise the consumer of not only the lenders the Mortgage Broker had access to but also the lenders the Mortgage Broker did not have access to.
- Lenders introduce an industry agreed upfront and trail commission payment that would alleviate any concern that a Mortgage Broker has used a particular lender due to receiving a higher commission structure.
- Annual professional development for Mortgage Brokers be solely connected with relevant industry training and no professional development points should be allocated to the Mortgage Broker for subscribing to industry publications.

SPECIALIST FINANCE GROUP

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