Manager
Financial Services Unit
Financial System Division
The Treasury
Langton Crescent
PARKES ACT 2600

30 June 2017

Dear Ms Moore

SUBMISSION - ASIC REVIEW OF MORTGAGE BROKER REMUNERATION

Even before this review process has been finalised there has been a move by the banks to change existing arrangements in accordance with regulator proposals.

There have been closed door meetings with 'key industry participants' being the industry bodies, aggregators and lenders to 'progress reform' via an industry-based response to ASIC's proposals without details of discussions being made public or advised to mortgage brokers.

What are the proposed reforms and why is the discussion surrounded by secrecy?

It would appear from comments in the Australian Securities and Investment Commission (ASIC) report that it has been influenced by the Stephen Sedgwick's highly questionable and distorted review which was commissioned and paid for by the banks industry body the Australian Banker Association (ABA).

The remuneration paid by credit providers, directly to aggregators, and indirectly to mortgage brokers, is not paid by the loan clients per se. It is a commercial arrangement paid from credit provider's gross business revenue and is a tax-deductible business expense.

The rate of remuneration paid to the mortgage broker today is less than what it was 10 years ago yet the expectation of, and the workload on, and the cost to the independent and sub-contract mortgage broker has substantially increased.

My company Universal Wealth Management Pty Ltd holds an Australian Credit Licence. I have been employed in the Banking and Finance sector since January 1970. Mortgage Broking since 2001.

During my career I have observed consumers overall to be honest people who do not purposely deceive lenders in an attempt to obtain finance they can afford.

While I was a member of the Mortgage and Finance Association of Australia and the Finance Broking Association of Australia in my early years of mortgage broking I have not been a member for quite some years as I believe they have a conflict of interest with lenders and cannot represent the mortgage brokers' position in stakeholder meetings because of that conflict. They add no value proposition to my mortgage broking business.

The ASIC REPORT 516 - Review of mortgage broker remuneration was commissioned by a member of parliament who requested a review of the mortgage broking market to determine the effect of current remuneration structures on the quality of consumer outcomes.

> *"Consumer outcomes are multifaceted, and comprise a series of factors—such as price, product accessibility, product features, loan performance—which may vary in importance from consumer to consumer. We (ASIC) will focus on consumer outcomes that have the potential to be impacted by behaviour driven by different remuneration structures."*

The report sets out ASIC's findings and they have also set out a series of proposals that they suggest will “improve consumer and market outcomes”.

The intended narrowness of investigation, by ASIC, limited the focus to “**potential** impact of behaviour”. This review has distorted the value proposition of the mortgage broker and what their remuneration consists of, and the report has not identified many poor consumer outcomes that need to be discussed.

The model of mortgage broker remuneration is a well-established commercial payment system which has been in place for around 20 years.

Either the behaviour described as the focus of this report is evident or it is not.

> *“Who pays the broker?*
>
> *A broker's fee or commission for arranging a loan is often paid by the credit provider whose products they sell.*
>
> *Different credit providers pay different commission levels. This can potentially influence what loans the broker recommends to you. Sometimes a broker will charge you a fee directly (instead of, or in addition to, the credit provider's commission).*
>
> *Find out the fee structure for the broker's service, and compare fees charged by different brokers to make sure you get a good deal.*
>
> commission
>
> *A fee paid to an adviser or salesperson as an incentive for selling a particular product. An upfront commission is based on the sale amount of the product. An ongoing commission is based on the balance of the account.”*
>
> **https://www.moneysmart.gov.au/borrowing-and-credit/home-loans/using-a-broker**

Clarification of what a mortgage broker does and for whom needs to be rationally discussed and understood. Most mortgage brokers offer a fee free consumer service of sourcing suitable loan products from competing reputable lenders that potential borrowers want to know about and apply for.

Bank staff sell bank products including home loans. Mortgage brokers sell a mortgage broking service.

The mortgage broker is a researcher, a pre-qualifier, and a credit application assistant for the consumer. A consumer can research the market and apply for a loan without the assistance of a mortgage broker, however, they cannot pre-qualify themselves.

In a competitive market place a product sale is between a buyer and a seller:

- Buyers who are seeking a solution to a need
- Buyers who are eligible to make a purchase
- Buyers who have the financial ability to purchase
- Buyers who can authorise a legitimate purchase
- Together with a product manufacturer (seller) who can satisfy the solutions sought by the buyers.

Mortgage brokers are not agents for, or employees, of credit providers.

Mortgage brokers have no authority to approve or refuse any credit provider loan.

Mortgage brokers have no authority to accept or reject a lender loan contract proposed for a borrower.

The sale of a mortgage broker service (their product) with a potential borrower (their buyer) occurs well before the separate sale by a lender of a loan (their product) to a borrower (their buyer).

Advertising and Marketing produce brand recognition and are an invitation to find out more.

The sale of a lender product launches at the point a lender receives for assessment a signed lending proposal from a potential borrower. The sale concludes at the funding settlement of the loan.

My comments to ASIC's finding are in red.

Finding 1: The standard commission model is almost universal

…And misunderstood by many.

An aggregator is **commissioned by** a select number of credit providers to introduce prequalified consumers of credit who match the lending parameters for approval.

A commercial contract between the credit provider and the aggregator determines the terms and conditions of the business revenue paid for **commissioned work**.

The mortgage broker is **commissioned by** an aggregator to find consumers of credit that meet a select number of credit providers loan approval specifications.

A commercial contract between the aggregator and the mortgage broker determines the terms and conditions of the business revenue paid for **commissioned work**.

The mortgage broker introduces the loan application to the aggregator and submits the application and supporting documents directly to the lender.

Credit providers give authority, via accreditation, to individuals to access their systems, credit policy, application submission and approval processes. This lender centric access is given when specified training has been completed and recognised standards have been met. The "accreditation" is given to individuals not businesses, and removed at lender discretion, and is transferrable from one aggregator to another.

There is no remuneration contract in place with the lender and the accredited individual. Without holding at least one accreditation a mortgage broker is unable to operate in the industry, even if they hold a credit license.

However, people can be paid for referring new business to some lenders without any accreditation being required by the lender.

As part of holding an accreditation with a lender the mortgage broker **must** adhere to all directives given by that lender or the accreditation will be taken away and the introduction of business from that mortgage broker will be refused.

According to the data compiled by CoreLogic's comparator business, in the six-month period 1 April 2016 to 30 September 2016, the **average** mortgage broker nationally earned $83,000 in **gross** upfront and $59,500 trail income.

From the gross remuneration, a mortgage broker must pay GST, ASIC annual licensing fees, ASIC annual company registration fees, Professional Indemnity insurance premiums, ASIC approved Ombudsman External Dispute Resolution membership fees, Aggregator membership and service fees, IT software and hardware expenses, running an office costs, fuel and car maintenance costs, telephone and internet costs, compliance costs, marketing and advertising costs, Professional Development training costs, any hired staff costs, **and lender clawbacks**.

After paying all business expenses the mortgage broker can determine their annual profit or loss from the gross remuneration paid via the aggregator. This is the remuneration figure that can be compared to a bank employee income.

Mortgage broker remuneration and bank staff remuneration cannot be compared as various varieties of apples can be. Bank Staff are wage and salary earners who receive bonus remuneration incentives on top of their industry award wages. Mortgage brokers are self-motivated small business owners.

Mortgage broker businesses may employ accredited loan writing and support staff who they must pay wages to out of their gross business revenue or other means, or they may engage sub-contractors based on a split of upfront and trail payments they receive from the aggregator.

The standard commission model takes unfair advantage of independent and sub-contract workers.

The standard remuneration model made up of upfront and trail components, is paid for the introduction of new business, and only after the loan has been funded (can be two months after).

There is no payment made by lenders to the accredited introducer for the associated outsourced loan application submission process tasks they must adhere to.

Each lender requires the accredited introducer to follow its unique loan application policy and procedure processes before the file is considered for a credit decision.

Each borrower application submitted is required to be in the format directed by each lender, accompanied by their specified supporting documentation.

Even when presented as per the individual lender requirements the credit assessors can and do request further documentation that the mortgage broker is expected to obtain.

The mortgage broker is required to follow the loan application through every touch point during the assessment, approval, documentation, and settlement process.

The remuneration model does not pay for the work undertaken by the mortgage broker for the restructure of existing facilities, for some top up applications, or for the refused applications presented to lenders even when the application meets the advised credit criteria. Trail payments are normally calculated on the outstanding loan balance less any funds held in an offset account.

The remuneration model of upfront and trail payments to the mortgage broker, for the introduction of new business is a one way, not negotiable contract between the lender and the aggregator and is mostly applied across the whole industry with no difference in payment amounts across aggregators.

This is evidenced by simultaneous industry wide notification, by lenders, of what ‘the new rates’ of upfront and trail payments will be paid to the aggregators.

The mortgage broker has no input into the amount of upfront and trail remuneration paid, claw back penalty amounts, or claw back penalty timeframes or accreditation requirements.

The Australian Securities and Investment Commission **has not provided any evidence** that upfront and trail payments creates **conflicts of interest** for a mortgage broker to recommend a loan larger than the customer needs or can afford **to maximize their remuneration payments.**

A mortgage broker offers a loan sourcing service to consumers. It is not a rational proposition that a broker would risk their reputation or credit license authority by putting a small amount of business revenue over retaining happy clients to service and obtain referrals from over the long term.

There are many reasons why a loan size may be more than a consumer's immediate needs. They include but are not limited to qualifying for a better interest rate, and plans for; an increase in family size, education, personal and business investment, a reserve to cover for unexpected life events, travel, home renovation, weddings.

If the additional funds are held in a redraw facility or offset account there is no additional cost the borrower and if the loan repayments are principal and interest each repayment made increases the amount of principal being paid down on the loan.

If a mortgage broker discusses a larger loan size with the consumer, the consumer is free to say no they don't require or want it. It is an option the consumer is entitled to make a decision on. Ultimately it is the consumer who owns the security asset, signs the application form and loan acceptance documents.

The notion that a mortgage broker would put a client into a loan the customer cannot afford merely to increase their commission payment has no valid basis. To do so would breach general and responsible lending obligations under the National Consumer Credit Protection Act 2009.

ASIC has the power to ban individuals that they find operating outside the NCCP.

The Australian Securities and Investment Commission **has not provided any evidence** that upfront and trail payments **creates conflicts of interest** for a mortgage broker to recommend a loan from a particular lender because the broker **will receive a higher remuneration.**

This notion asserts that a consumer is an inactive participant in the loan application process. The lender must offer something the consumer wants or no application would occur.

A mortgage broker is not paid on recommendations. They are paid after the transaction between a satisfied lender and a satisfied consumer is completed.

To have transactions complete a mortgage broker must concentrate on lenders that consumers qualify with and have a suitable product and service offering to satisfy the consumers requirements or they won't get paid at all.

A mortgage broker is not required to have a certain number of lender accreditations. If they choose to only deal with lenders who pay the aggregator more for their skills and ability in finding sought after borrowers then that is a commercial decision that does not result in poor consumer outcomes or potential risky behaviour.

Consumers have broad qualification needs. Lenders have specific qualification requirements. The task is to get together the right need with the right requirement.

When a mortgage broker makes a commercial decision to hold a small number of accreditations they are limiting their scope of service to consumers. However, they will be an expert in the lenders, they chose to deal with, products, policy, and processes. As a result, they may be more efficient than other mortgage brokers who are less familiar with that set of lender requirements.

This strategy can enhance competition because other lenders will ask why they are not getting business from those successful brokers and look at their what their offering is.

No mortgage broker can help all consumers that approach them for assistance.

A mortgage broker not being able to assist all consumers, or deciding to specialise with a certain demographic of consumers or lenders is not a root cause of poor consumer outcomes.

The Australian Securities and Investment Commission **has not provided any evidence** that upfront and trail payments **creates conflicts of interest** for a broker to recommend a loan that may not be **the best loan for the consumer**.

The ASIC proposed 'lender choice conflict' is a very subjective not objective construct. What is the best loan for the consumer? Based on what quantitative measure? Price? Product accessibility? Product features? Loan performance? As stated by ASIC these aspects vary in importance from consumer to consumer.

A consumer may want a loan from a lender but the lender may not want business from that consumer.

The National Consumer Protection Act 2009 does not require a mortgage broker to recommend "the best loan" for the consumer (nor could a mortgage broker always in commercial reality).

"The best loan" proposal is a fantasy expectation.

The ASIC proposed 'product strategy conflict' suggests that the applicants applying for a loan through a mortgage broker have no say in which lender they make application to or the loan amount they apply for.

Aggregators receive remuneration for the introduction of new business to lenders. The more new to bank business that is funded the more remuneration is paid.

Maximum commission limits apply with some lenders and on certain products. Some lenders will only pay a percentage of the approved loan amount on certain products and others may clawback if the loan has not been fully drawn down within a specified timeframe. Some products have a flat fee upfront payment with no trail component. Others pay no commission on certain products. No payment is made for the restructuring of existing business.

Most lenders pay the same rate of commission on a settled loan whether there is one loan of $1,000,000- or five loans of $200,000-.

It is harder to find consumers that need and qualify for larger loan sizes and the financial situation for people of this stature is usually more complex and time consuming.

CLAWBACK is a practice that is sanctioned by Australian Prudential Regulatory Authority in APG223 and by the Australian Securities and Investment Commission during this review.

Clawback is unethical because the mortgage broker has no right to negotiate lender remuneration contract terms as they are not a party to the commercial contract and the lender applies the clawback provision blanket across the whole industry.

When clawback has been previously raised with ASIC and ACCC both have indicated it is a commercial arrangement that they cannot interfere with. The advice has been that the courts were the place to obtain a legal determination to establish if the banks were guilty of misusing their market power. The cost to initiate such legal proceeding by an individual broker is financially prohibitive.

Extract from APRA draft APG223 Residential Mortgage Lending July 2014

17…Where the residential mortgage lending portfolio is material, a prudent ADI would apply its remuneration policy to the persons involved in residential mortgage lending, including remuneration of third parties, particularly mortgage brokers, when they are responsible for origination of a material proportion of the residential mortgage loan portfolio.

18. In Australia, it is standard market practice to pay brokers either an upfront commission or a trailing commission, or both. Experience has shown that commissions paid upfront tend to encourage less rigorous attention to loan application quality. Trailing commissions are more likely to provide incentives for brokers to retain and monitor customers. A prudent approach to the use of third parties for residential mortgage lending would include appropriate compensation measures for brokers. Such measures include the ADI being able to end or claw back commissions where there are high levels of delinquency or process failures on loans originated by third parties.

Extract from 21 July 2014 ABA submission to draft APG223 Residential Mortgage Lending

"Paragraphs 17 to 19 remuneration policies - CPS 510 requires the board approved ADI remuneration policy to be aligned with prudent risk taking. Draft APG 223 outlines that an ADI's remuneration policies include amounts paid to third parties, in particular mortgage brokers where they originate a loan. Further, there is an expectation of a claw back of commissions in particular circumstances. The suggestion that an ADI's remuneration policy be applied to non-employee brokers is problematic for a number of reasons. First, it ignores that mortgage brokers and their remuneration is already subject to regulation under ASIC's credit licensing requirements. Second, it does not represent commercial reality and the existing contractual arrangements between ADIs and mortgage brokers. It is not appropriate to extend ADI remuneration policies which are intended for salaried staff to mortgage brokers. Any general contractual term ostensibly allowing an ADI to claw back commissions may contrast the prohibition of penalties in the law of contracts, thereby rendering the term void. The ABA recommends that these paragraphs be amended to remove the application of the ADI's remuneration requirements to mortgage brokers who are covered by their own NCCP obligations. We note that APS 510 was subsequently changed for the same reasons,"

Reference to mortgage broker remuneration in the national consumer protection act 2009 is restricted to record keeping and disclosure of payments to consumers.

"…it does not represent commercial reality and the existing contractual arrangements between ADIs and mortgage brokers…"

The commercial reality is the monetary contractual arrangements are between ADI's and aggregators not ADI's and mortgage brokers as asserted. Being a major stakeholder did the ABA suggest the change in the draft prudential regulatory guide to enable covert behaviour to take advantage of the independent and subcontractor mortgage brokers or are they unaware of how mortgage brokers are paid?

Extract from Final November 2014 APG223 Residential Mortgage Lending

16…This would include remuneration of third parties, particularly mortgage broker firms, when they are responsible for origination of a material proportion of the residential mortgage loan portfolio. For the avoidance of doubt, the ADI remuneration policy is intended to capture an ADI's engagement with its brokers, not how a broking firm pays its staff. Alternatively, the ADI may address such remuneration arrangements within its risk management framework with appropriate senior management or Board oversight.

17. In Australia, it is standard market practice to pay brokers either an upfront commission or a trailing commission, or both. A prudent approach to the use of third parties for residential mortgage lending would include appropriate measures to ensure that commission-based compensation does not create adverse incentives. Such measures would include consideration of appropriate claw back provisions and ensure that incentive arrangements discourage conflicts of interests and inappropriate behaviour.

"commission-based compensation" is a misleading term when referring to the gross business turnover a mortgage broker is paid for commissioned work.

The changes made by APRA in the final prudential regulatory guide do not reflect that the commercial risk is being transferred from banks to mortgage brokers, under the guise that taking back mortgage broker remuneration is considered by the regulator to be prudent behaviour.

The assertion that CLAWBACK is designed to discourage mortgage brokers from refinancing (or 'churning') consumers to a new lender so the broker can **potentially** earn a new up-front commission is simply not true.

With clawback an aggregator and the mortgage broker do have their gross business turnover taken back by banks for up to two years after the transaction between the lender and consumer has been completed.

The commercial risk of the bank is inappropriately transferred to the mortgage broker via the bank - aggregator contract. A bank induced "industry standard".

Mortgage brokers can be placed into a position of financial distress or insolvency if they receive several unexpected clawbacks in a short period of time.

The mortgage broker is taken advantage of by being clawed back when they have no control over what a consumer decides to do post settlement. Such as, selling their home or investment property, refinancing because they are dissatisfied with bank performance or pricing or any other reason, employment changes, personal relationship breakdowns, and lender policy restrictions.

For example, email received on 15 June 2016 from a client detailing her reasons for wanting to refinance after being with a lender for 6 months:

> *"Hi Maria,*
>
> *Below are some thoughts on my experience with "ABC Bank". I think I've captured the dates and information accurately but feel free to edit any of the dates etc if they are inaccurate.*
>
> *Initially I'd signed up my investment loan with "DEF bank" June 2014 as the property settled. Application process and experience with them was seamless and very straightforward and was completed within a timely manner with a 5 year interest only period, loan term 30 years.*
>
> *November 2015, "ABC Bank" were offering 3.99% pa for investment loans interest only which was substantially lower rate than what I was receiving from "DEF bank". We'd started the application process with "ABC Bank" around 11/11/15 and this continued until 22/01/16 which was a totally unacceptable and unreasonable time to wait. The experience with "ABC Bank" application was one of the most stressful times. They kept asking for further documentation to support my application, requested that I reduce my credit card limit which I agreed to, were talking about reducing my loan term from 30 years to 25, were questioning my income protection deductions. Even after we'd complied to their requests, the process kept dragging on for a number of weeks. Eventually we'd realised that my age (54) was an issue with them to which they agreed when you questioned them. I'd considered myself to be a low risk to them with a stable income, no personal debt, having paid off and owning my family home, paying off my credit card monthly but to then hear "ABC Bank" were considering me to be a high risk was an insult. Not only that, signing up originally with "DEF bank", none of the above was any issue with them.*
>
> *Eventually they'd approved the loan 22/1/16, 3.99%pa, 5 years interest only, with repayments occurring 20th of each month, the first one being 20th Feb. Less than 2 weeks later, "ABC Bank" decided to increase their interest rate 1 Feb, I hadn't even enjoyed the luxury of having one repayment at 3.99%. I'd emailed my "ABC Bank" contact thinking this was a mistake with no response for over a week. I'd followed up my original email to be told she'd passed my details onto her contact and someone will be ringing me "soon" to explain the interest rate. Someone eventually rang 2 weeks or so later.*
>
> *Then "ABC Bank" sent out another letter 15 April, increasing their interest rate and a further letter 18 May with another increase. All in all, there were 3 rate increases in less than 6 months.*
>
> *The whole "ABC Bank" experience along with their numerous rate increases has left me very nervous and disappointed. I feel that they're unreliable and untrustworthy. I'm also extremely anxious when thinking about having to go through all that process again with them in less than 5 years when my interest only term is up which is the main reason for looking to another provider who is offering a much longer interest only term.*

Regards
Client name

The consumer suffered unnecessary stress and anxiety. As the mortgage broker, I was placed in a monetary loss situation due to deficient performance of the lender. 100% upfront clawback. The new lender paid the consumer a $1,500- refinance rebate to assist cover her costs of moving her business to them.

Another example is a fellow broker recently rang me to ask if I knew of a lender who would lend an 80% loan to value ratio on a certain type of security property. I advised the details of the bank I knew would consider such a proposal. My fellow broker unfortunately did not have an accreditation with that lender. The client had a loan of 70% (maximum available with current lender) but required a top up to 80% to complete some property upgrading that was not previously contemplated.

The loan had been in place with the current lender for 8 months. My fellow broker suffered a 100% clawback of the upfront payment paid. The new lender paid the client a $1250- refinance rebate for refinancing to them. With one hand lenders incentivise consumers with money offers to refinance to them then with the other hand take back the mortgage broker payment for completed work to compensate themselves.

Finding 2: Brokers are paid bonus commissions and lenders' staff are paid bonus payments

"the closer the aggregator gets to the target, the greater the incentive they have to write additional business for that lender" Remuneration is paid on settlements not applications and the timing of settlements occur at the convenience of the lender and the borrower not the aggregator or the mortgage broker.

Not all mortgage brokers have accreditations with all the lenders on their aggregator's panel.

Not all aggregators have the same lenders on their panel as other aggregators.

The suggestion that aggregator software is somehow being manipulated to lure mortgage brokers to write more business with a targeted lender is naive because it would not work efficaciously in the real world of mortgage broking.

"*Payment of bonuses to staff is an area of similarity in remuneration for the broker channel and lenders' staff.*" This is not factual or an honest portrayal of how mortgage brokers are remunerated.

Volume-based commissions - Lenders may pay commercial payments to aggregators for reaching a target in mortgage loan settlements over a period. These payments are not part of the aggregator - mortgage broker contract.

Mortgage brokers are not advised when or how or under what terms these commercial payments are made.

A mortgage broker who introduces larger volumes of settled loans to an aggregator can negotiate a higher proportion of the standard upfront and trail payments received by the aggregator across all lenders they hold an accreditation with.

For example, the percentage split might go from 80/80 to 85/85 to 92/90 to 95/95 depending on value of consistent monthly settlements. This can only occur if an aggregator is commercially rewarded for increased settlement levels or portfolio expansion as they have business expenses to pay out of the gross remuneration payments they receive.

The less remuneration an aggregator receives the less remuneration mortgage brokers receive.

Upfront and trail remuneration information is not included in aggregator (AFG) lender product comparison software. Remuneration information is found in a different part of the broker website.

Mortgage brokers write the business, aggregators facilitate the process and provide lender access infrastructure. I have been a mortgage broker since 2001. In that time, I have never seen or heard of aggregators pushing to influence which individual lender an individual mortgage broker should recommend to their clients because of a rate of commission being offered.

I have seen attractive interest rate discounts being offered on loan products and a slightly higher remuneration payment being offered for finding consumers who want to take option of the lender offering. I see this as a lender marketing opportunity that reflects the additional effort a mortgage broker would need to contribute to find and qualify potential borrowers they want to do business with.

We see a perception in this report that all consumers qualify with all lenders all the time, and a mortgage broker's main consideration is how much more commission one lender pays over another.

Not all mortgage brokers have accreditations with all lenders. Not all aggregators have commercial arrangements with all lenders.

The perceived conflict of interest is not a rational deduction of the commercial reality of the arrangement between the lender and the aggregator and the aggregator with the mortgage broker and the mortgage broker with the consumer.

It is logical to conclude that the more mortgage brokers an aggregator has introducing quality business to them the greater settlement volumes they will achieve across all lenders on their panel. Competing banks want knowledge about and access to aggregators and mortgage brokers so they can sell their proposition.

The more consumers there are that use a mortgage broker service the harder banks must compete on product, price and service.

If Volume-based incentives arrangements are removed the following will occur.

1. Competition between banks will lessen
2. The banks will make more money
3. On the surface, the aggregator will be paid less
4. Mortgage brokers will be paid less and good mortgage brokers will exit the industry. Instead of receiving the current split of up front and trail payments the mortgage broker split will be reduced.

Campaign-based commissions – Mortgage brokers are independent and sub-contractor workers paid a remuneration for a service that has been commercially commissioned by aggregator businesses.

The remuneration received by mortgage brokers from the aggregator is gross business turnover not a wage or salary.

Lenders staff are employees; they take no commercial risk or are they responsible for things going wrong. As PAYG income earners lender staff receive holiday pay, sick pay, superannuation, long service leave and other entitlements that mortgage brokers do not.

Lender's staff are paid bonus payments on top of their salary, mortgage brokers are not.

In effect mortgage brokers are very rarely paid an elevated remuneration in the form of described "bonus commissions". If such payments are offered it is for a unique proposition. Usually a "low consumer interest rate" is offered as well for a limited timeframe and the "reward payment" is for a combination of specified products, loan to value ratio, and loan amounts.

We do not view submission quality or conversation rates or LVR or product centric upfront payments as “bonus commissions” as they make up part of the standard upfront payments.

An ASIC directed reduction in mortgage broker remuneration communication received via email on 29 June 2017 reads:

> *“We are writing to confirm that “This Bank” is varying the commission schedule to have a flat upfront commission rate for our XXXX Home Loan range.*
>
> *The decision is in-line with market expectations and likely outcomes from the ASIC remuneration review. Applications received on or after 1st July 2017 will attract the new rate of 0.XX% (inclusive of GST)...”*

Finding 3: Soft dollar benefits are widely used in the broker channel

ASIC has provided no evidence that soft dollar benefits are a “*significant” or any other “motivator”* for brokers **to send loans to a lender to qualify for those benefits**.

Any sponsored or hosted event is a soft dollar occasion. As is a relationship manager buying a mortgage broker a coffee at a catch-up meeting.

To attend the sponsored or hosted events or catch-up meetings the mortgage broker needs to take time away from their business. Unlike salaried staff, time away from their business has a monetary impact on the mortgage broker.

Competing banks and aggregators want knowledge about and access to successful mortgage brokers so they can sell their proposition. A way to do this is to sponsor or host industry events.

Banks have a professional responsibility to ensure their accredited people are kept up to date and informed about their products, policy, compliance and procedural changes. A way to do this is to sponsor or host industry events or have one to one or small group catch-up meetings.

Sponsored Professional Development days and conferences have traditionally been a way for industry players to update mortgage brokers about their current propositions and lenders discuss their appetite for what type of business they want introduced.

At these events mortgage brokers can engage with lenders and aggregators that they are not familiar with. Mortgage brokers meet other mortgage brokers and discuss all sorts of industry happenings and concerns.

These types of events are beneficial to competition and all participants in the industry, and are only possible with bank and aggregator monetary support.

It is a very small percentage of mortgage brokers who are wined and dined, and entertained in Australia, and at overseas conferences by lenders and aggregators. Some brokers who qualify do not take up the option.

Terms like ‘business partner’ are often associated with *Loyalty programs* which have been described in this report as if they are something a mortgage broker aspires to be a member of. The lender or aggregator selects the criteria and places the mortgage broker into the club. Lenders then champion the business partnership arrangement. These programs come from a sales mentality, not a service culture and lenders miss out on business because their focus is not on the end user of their product or the end user’s assistant.

Mortgage brokers are not paid a commission by the lender so they cannot be paid a better commission rate for being a member of a bank’s broker club as stated in this report.

"…*improved service levels will allow the broker to have more loans approved by the lender in a shorter time, which will result in more commission being paid to the broker*."

Tiered service levels come from a sales mentality, not a service culture and does produce poor outcomes for consumers and mortgage broking businesses.

ASIC includes the service levels lenders provide to loan applicants as a mortgage broker soft dollar benefit. It cannot be as a loan application process is a service offering to consumers, not mortgage brokers.

National Consumer Credit Protection Act 2009 states:

General conduct obligations

(1) A licensee must:

(a) do all things necessary to ensure that the credit activities authorised by the licence are engaged in efficiently, honestly and fairly; and

(b) have in place adequate arrangements to ensure that clients of the licensee are not disadvantaged by any conflict of interest that may arise wholly or partly in relation to credit activities engaged in by the licensee or its representatives;

Rather than being a soft dollar incentive for the mortgage broker I view that that any lender who prioritizes the processing of some mortgage broker client applications over other mortgage broking client applications is in breach of their general conduct obligations under the NCCP.

Tiered service levels are not efficient, honest or fair. They come out of a sale versus service conflict which disadvantages some consumers over other consumers just because of the mortgage broker they have chosen to utilise.

Finding 4: Consumers who use brokers are different to consumers who go directly to lenders

Mortgage Broker clients usually have an established relationship with at least one banking business.

Mortgage Brokers offer a service that is unavailable to consumers who go directly to their bank or use online comparison websites.

Not all consumers, yet, are aware that a mortgage broker can be their personal researcher, loan pre-qualifier, and a loan application assistant.

Younger consumers display far less loyalty to their current banker than past generations and are on the lookout for people and things that make life easier for them.

Banks do not want to lend money to all credit worthy consumers. They select a typical type of borrower they want to do business with and market products to attract them. Not all their customers will fit their approval criteria. When this occurs, consumers will seek alternatives.

Finding 5: Loans obtained through brokers are larger, and more likely to be interest-only

When people purchase a home or an investment property they usually have a limited amount of cash and savings so they rely on a lender to borrow the balance they need.

There can be large variations in the amount people can borrow across lenders due to capacity to repay testing, appetite for business, and other policy restrictions. Some lenders are more conservative than others.

This does not mean that less conservative lenders are not responsible or prudent.

It is expected that loans via a mortgage broker will in many cases have larger loan amounts and higher LVRs than the direct channel due to the number of lenders a mortgage broker has a capacity to lodge a deal with.

If a consumer needs a 95% LVR to complete purchase of a property and their current banker will only lend a maximum of 90% or 80% LVR a mortgage broker may find them a lender that can accommodate their objective of purchasing a property and their requirement of having enough money to complete their purchase. This will increase the loan size as well.

Some lenders have more conservative capacity to repay testing than others. The criteria of testing can change with a lender at any point in time depending on their appetite to take on new business.

If a consumer applies for a loan and they fail the capacity to repay test with their current banker then chances are a mortgage broker, through having access to many lenders, will be able to find the consumer a lender that will lend them the money they require.

This does not mean responsible lending and responsible borrowing is not occurring or the mortgage broker is placing the application with a lender to maximise their "commission".

Industry standard capacity to repay testing has a history of the new loan being assessed as principal and interest repayments over the amortization term with a buffer rate being applied. This is regardless of the repayment option being requested by the consumer.

Some lenders would also apply this principal to existing debts the consumer has. Other lenders would test using the actual repayment the consumer was contracted to pay.

Creditworthy consumers with a proven history of being a reliable payer will be disadvantaged and be refused loans due to the recent push for loan applications to be all assessed at amortization terms using a loaded interest rate. This imposed standard on commercial interactions between a banker and a consumer will produce less competition and interfere with a consumer's free will decisions in their financial planning.

What is being missed by APRA in their prudent lending regulation and by ASIC in their responsible lending regulation is they are producing poor consumer outcomes for everyday Australians and creating financial stress and strain that previously was absent in the market place.

Back-book interest rate increases are rife. *"To continue to meet our regulatory commitments, we are increasing interest rates for Interest Only loans".* For existing and new borrowing.

In 2008, it was standard for the interest rate on Line of Credit, and Standard Variable Rate (Investment and Owner Occupied) (Interest Only and Principal and Interest) loans to be the same. In the current rate movement environment one of the Big 4 has just announced changes that demonstrate a:

- .03% p.a. reduction on owner occupied P&I home loans
  - Equates to approximately $78- saving per year on a $350,000- loan
- .45% p.a. higher rate for owner occupied I/O vs owner occupied P&I
  - Equates to $1,575- additional interest payment per year on a $350,000- loan
- 1.02% p.a. higher rate for investment I/O vs owner occupied P&I
  - Equates to $3,570- additional interest payment per year on a $350,000- loan
- 1.16% p.a. higher rate for Line of Credit owner occupied and investment loans vs owner occupied P&I
  - Equates to $4,060- additional interest payment per year on a $350,000- loan

For the consumer of an owner-occupied home who has a line of credit with this lender they need to find an extra $4,060- of **net** income per year to service a debt they may have had for 10 years. Just because the type of facility has somehow now been perceived as more risker for the lender or the lender is required to hold more capital to satisfy APRA regulatory rules or follow ASIC directives.

The consumer's home that they have provided to the lender as security, in the case of default on repayments, would have increased in value so decreases the risk of loss to the lender.

The increased repayments place pressure on household finances and instead of money being available to reduce the outstanding balance it is given to the bank. The money paid in extra interest is not available to pay increasing fuel costs or to purchase consumer goods and services.

A poor outcome is evident when a consumer has a loan that provides them with a level of flexibility to manage their finances in a manner they desire, during various life stages, then they suddenly find their loan is no longer considered by the regulator as suitable for them so they must pay more to keep it.

> *Announcing current interest rate changes Bank CEO said "the changes are necessary to ensure the Bank complies with macro-prudential measures introduced by APRA, while encouraging existing interest-only home loan borrowers to switch to principal-and-interest.*
>
> *Owner-occupier principle-and-interest home loan rates are at record lows. Now is a great time to pay down the principal on your home loan."*

Result is unless the consumer complies with the regulators wishes for them to pay down the principal of their loan the banks charge them more interest or refuse to provide them with a loan. Their ability to refinance becomes limited or nonexistent.

ASIC's insistence that principal and interest loans are in the best interest of the consumer goes against the grain of the NCCP protection against unsuitable loans. Lenders and mortgage brokers must consider the consumers requirements and objectives and their financial situation.

In an example like this:

> *As you know we have two children who are 16 and 13. Our daughter is in her final two years of school and is also a professional singer which at present we are supporting with weekly lesson and many other things. Clearly, they are both fully dependent.*
>
> *My business is expanding in Australia and with the marketing I am doing I am confident that my income will continue to improve over the next few years. At present, I am needing to spend additional money on advertising to further increase my business in Australia and Asia.*
>
> *I wish to stress that the only reason I am wanting an interest only loan so that we can increase our cash flow. All our income will go back into the mortgage as our desire is to reduce the size of our mortgage to a much lower level as soon as we can. A principle and interest loan will increase our current costs and that would-be counter to our current planning.*

The consumers requirements and objectives are ignored because they are using their principal place of residence as security for the loan.

It is the regulator who has approached most lenders and reviewed interest only policies and expressed their concerns regarding interest only loans when secured by principle places of residence. They have had very strong views on interest only for the purposes keeping repayments low and this has resulted in lenders being unwilling to assist with the request by consumers to approve interest only repayments even thought that is what the consumer wants**.**

An economic consequence is principal repayments remove money from society.

Finding 6: Interest rates are not different between distribution channels

They can be and often are.

Finding 7: Lenders and brokers did not make sufficient inquiries into consumers' expenses

A lender needs to be aware of discrepancies and inaccuracies in loan applications and have an eligibility process in place to approve loans for borrowers that can demonstrate that they are able to repay their debt.

It is not only the repayment capacity that creditors need to assess it is the whole picture.

Credit worthiness looks at the applicants' history, loan purpose, demographics and capacity to repay via disposable income.

Credit Providers are experienced in the lending money business and use this "experience" to match applicant profiles with similar profiles to assess the probability of the current applicant resulting in non-performance (delinquency or write-off).

The assessment is not based on the individual themselves but how they compare to other borrowers with a similar loan profile.

Unlike a positive credit scoring system, which is used to discriminate against credit worthy people, the old credit history system gave the lender an idea of the consumers' reputation as a borrower.

How reliable have they been in making their contracted repayments? Does the history demonstrate any non-payment defaults? Has the consumer been a responsible borrower?

When a consumer is asked how much they can afford to repay a new loan comfortably and stretched they can tell you.

When a consumer is asked how much their basic monthly living expenses are most can tell you ballpark. Even if they don't use a household budget.

Most consumers know how much money is coming into the household and how much is going out without having to sit down and break it down into utilities & rates - owner occupied property, utilities & rates - investment property, telephone, internet, pay TV & streaming services, groceries, recreation & entertainment, clothing & personal care, medical & health (excluding Health Insurance), transport, education, childcare, insurance, and other.

To establish actual living expenses accurately a consumer would need to take the last 12 months accounts and shopping receipts categorize them, add them up and divide by 12. That is not a reasonable inquiry into expenses nor will it apply once the new loan is taken out.

The NCCP requires "Reasonable" inquiry… which means as much as is appropriate or fair; moderate.

(a) make reasonable inquiries about the consumer's requirements and objectives in relation to the credit contract; and

(b) make reasonable inquiries about the consumer's financial situation; and

(c) take reasonable steps to verify the consumer's financial situation;

When a consumer is expected to explain in detail and the mortgage broker is expected to document the detailed conversation about why a consumer wants a variable rate loan over a fixed rate loan, the inquiry is not reasonable.

When consumers say that the detail and evidence required to demonstrate their living expenses is an invasion of their privacy one can conclude that the inquiry is not reasonable.

When consumers have a proven repayment history and are asked to provide bank statements for their salary deposited transaction accounts to verify their living expenses and prove that they have no undeclared loan repayments the inquiry is not reasonable.

When a lender staff passes comment about the amount of money that is showing on transaction statements being spent at take away food stores the inquiry is invasive and not reasonable.

When a consumer asks for a credit card limit to be reduced and they are asked to supply their tax returns the inquiry is not reasonable.

When a 49-year-old and their spouse earning good income, proven repayment history, and have more than 60% equity in their home are asked why they do not have more assets and superannuation at their age the inquiry is not reasonable.

When a spouse guarantor has non-income amounts (not required for, or allowable to meet serviceability testing) deposited into their personal savings account it is not reasonable inquiry to ask where those deposits come from.

When a consumer seeking to refinance a 50% LVR loan with a proven repayment history at a 1.06% p.a. higher interest rate, is refused credit because they did not provide three months of a closed credit card account statement for the credit assessor to verify living expenses the inquiry is not reasonable.

When people, because of their age, are asked to provide evidence of their superannuation balances to demonstrate now they have sufficient cover to pay off a loan, at retirement in 10, 15 or 20 years' time, the inquiry is not reasonable and the inquiry is age discrimination (without actuarial or statistical data demonstrating the age group is a poor credit risk).

Age discrimination is becoming standard industry practice. For the consumer, refinancing a current loan to a cheaper interest rate may not be possible. The non-property owner is being locked out of the home ownership dream and being forced to stay in the rental accommodation market.

If a consumer is 65 years old and is 10 years into a 30-year loan term they would have accumulated 10 years of equity made up of capital growth and repayment of principal. Repayment commitment would remain static until they repaid the loan in full. Without a loan after 10 years the consumer will still be paying rent and the rental payment commitment will have increased.

Finding 8: For some lenders, loans provided through brokers are more likely to go into arrears than loans provided directly to consumers

<u>THE MORTGAGE BROKER HAS NO AUTHORITY TO APPROVE A LOAN OR TO ACCEPT A LOAN CONTRACT ON BEHALF OF A CONSUMER.</u>

A mortgage broker is not a guardian of a consumer's income to ensure scheduled contracted repayments are made.

Mortgage broker remuneration and how a borrow conducts their finances after the funding of a loan are mutually exclusive. One is not related to the other.

An upfront payment is received when the consumer loan is settled.

A trail payment is made when loan repayments are paid on time.

Therefore, a mortgage broker has a motivation to introduce new business only from credit worthy people who are most likely to make their repayments on time.

Finding 9: Competition in the home loan market is affected by ownership and the limited ability of some lenders to access and remunerate brokers

Third line forcing is prohibited no matter what its effect on competition yet, as part of the mortgage broker accreditation process, most credit providers insist that membership of one of the two industry bodies (MFAA & FBAA) is mandatory.

The MFAA and FBAA's income comes from sponsorships and member fees.

Membership of one of these two organisations is required by the lenders before a mortgage broker can obtain, or transfer an accreditation to a different aggregator. The lender will not accept business proposals from a mortgage broker that does not hold an accreditation.

The relationship between the industry bodies and the lenders conflicts with the relationship between the industry body and the mortgage broker.

This restrictive imposition stops consumers and mortgage brokers alike from choosing who they wish to deal with in the market place. The imposition forces mortgage brokers to spend money on a membership fee they don't want or they risk becoming uncompetitive because they cannot obtain accreditations with new / emerging lenders or transfer to a competing aggregator.

Smaller lenders can become bigger lenders if they are authorised to be on an aggregator's panel.

When an appointment to a lender's panel occurs, a commercial arrangement is formulated.

The aggregator must decide if the lender is of good reputation, has competitive products, is financially sound and has the infrastructure to cope with the volume of business that will be introduced to them via the mortgage broker network.

Not all small lenders have the capacity required to be on an aggregator's panel.

'Vertical Integration' that supports manipulative market dominance is the Australian standard.

The push to make white label products a key distribution product for aggregators is a direct result of vertical integration. Some say it is to avoid channel conflict between the branch staff and mortgage brokers. Either way it is a smoke and mirror consumer and mortgage broker minefield because the same funder can be suppling money to a stack of labels.

If the consumer refinances from one white label to another white label and then to the branch of the funding bank then it is an illusion of competition, no competition at all is occurring. It is not a profitable long-term strategy to undercut your own pricing.

Vertical integration can mean a company maintains clear-cut control and is never dependent upon products manufactured to quality standards less demanding than its own.

Vertical integration can mean the reshaping of the company through efficiency to be independent from inefficiency in the supply chain **OR** it can mean buying out the competitor to ensure market dominance of the distribution chain and the unknowing vulnerable consumer.

The latter is what has happened in the Australian aggregator / mortgage broker landscape.

National Australian Bank and Commonwealth Bank of Australia were the two banks who most severely resisted the emergence of the "Mortgage Broker" profession. Now through 'vertical integration' they own and control large aggregation firms and " loan product brands".

By owing aggregator businesses two of our major banks have all the product specifications, details of fees and charges, credit policies, for all lenders on their panel.

They have knowledge of where their member mortgage brokers lodge deals, how much mortgage brokers are paid via the various remuneration contracts through their ownership of mortgage broker aggregation firms.

Through 'vertical integration' they have at their fingertips their competitor's information. They get paid by their competitors for loans mortgage brokers introduce to increase the business of their competitors.

Each lender exclusively determines the remuneration rate they will pay each aggregator and the amount it will charge a borrower and under what circumstances.

It has been stated that National Australia Bank does not pay incentive commissions to aggregators as the other banks do. This bank is the owner of Advantedge Financial Services and has many white label brands that it funds. There has been insufficient disclosure around the push to drop "bonus commission payments" and how aggregators will be able to make up the shortfall in income to stay profitable.

The major banks issue covered bonds that offer investor protection over bank depositor protection. This makes this type of bond more attractive to investors and harder for smaller player to compete. Smaller lenders and loan businesses that operate using securitization are at a competitive disadvantage.

There has been no conversation had in either the ABA Sedgwick review or the ASIC review relating to this matter and if the changes to aggregator and mortgage broker remuneration is a motivating factor behind the ASIC and ABA Sedgwick's push to change the remuneration model.

Finding 10: Lenders provided bigger loan discounts for new loans in 2015 compared with 2012

Maybe, and loan discounts in 2017 are less than they were in 2016.

Mortgage lending is a competitive market – discount offerings move with the level of genuine competition in the market place.

Finding 11: Those who merely refer consumers to lenders are paid almost as much as brokers, despite doing much less than brokers

Yes, and this confirms that the mortgage broker is being taken commercial advantage of by the lenders.

Finding 12: Governance and oversight need to be improved

Mortgage Brokers do not sell home loans, they sell a mortgage broking service.

Mortgage Brokers are not employees of banks or aggregators.

Mortgage Brokers are required to hold an Australian Credit Licence or be an authorised representative of an Australian Credit Licensee. Their behaviour and business is overseen by ASIC.

The mortgage broker client is the consumer. Their focus therefore must be on the consumer or they won't have any loans to introduce to the aggregator and they won't get paid.

Mortgage brokers are the preferred distribution channel by more than 50% of consumers seeking a mortgage loan this is evidence that the mortgage broker professional is part of a consumer-focused culture.

Finding 13: Data quality and public reporting

Most lenders provide each mortgage broker with an accreditation number that consists of aggregator / individual identification.

Proposals

We note that the proposals suggested by ASIC are very commercially advantageous for the banks and appears to be swayed by the ABA paid for Sedgwick opinion.

Proposal 1: Improving the standard commission model

We do not support this proposal as it is based on perceived potential risks that are not evident in a commercial remuneration system that has been in operation for over 20 years.

This proposal will reduce mortgage broker remuneration for no valid reason.

I completed a submission to the Australian Bankers Association commissioned Stephen Sedgwick AO report which was not published on the Sedgwick website. I suspect my submission was not made available to interested parties as it did not support the interests of the ABA and challenged many of the assertions the reviewer made.

A copy of the submission is available to the Treasury upon request.

Proposal 2: Moving away from bonus commissions and bonus payments

We do not support this proposal as it is based on the premise that mortgage brokers are unethical operators and that bonus commissions are the same as what financial planners and bank staff have received.

This proposal is designed to allow the banks to reduce aggregator and therefore mortgage broker remuneration for no valid reason.

Proposal 3: Moving away from soft dollar benefits

We do not support this proposal as there has been no evidence presented that supports the assertions made that poor consumer outcomes are a result of this benefit.

Proposal 4: Clearer disclosure of ownership structures

We support this proposal in principal – clearer disclosure of ownership structures does not go far enough.

Proposal 5: A new public reporting regime

We do not support this proposal it is impractical, time consuming, and full of information that is irrelevant to the consumer in obtaining good customer outcomes.

A history of past events is not reflective of what happens in the now moment or the future.

Proposal 6: Governance and oversight

We do not support this proposal as mortgage brokers are already a customer-centric culture.

ASIC is the regulator of the Australian Credit Licence regime and has oversight responsibility over the behaviour of those who operate in the industry.

The accreditation system gives banks and aggregators oversight of mortgage brokers.

The industry Ombudsmen's provides governance and oversight to all the industry players.

The commercial arrangements between the banks, aggregators, and mortgage brokers is not the business of ASIC.

I am available to discuss further.

In good faith.

Maria Rigoni
Mortgage Broker
Universal Wealth Management Pty Ltd
mariarigoni@icloud.com
0416 203 028