30 June 2017

Ms Diane Brown
Division Head

Financial System Division

The Treasury

Langton Crescent

PARKES ACT 2600

By email: consumercredit@treasury.gov.au

Dear Ms Brown,

**ASIC Review of Mortgage Broker Remuneration – Invitation to Comment**

**Submission by Australian Finance Group Ltd ACN 066 385 822**

**Background**

Australian Finance Group Ltd (**AFG**) was founded in 1994, was listed on the Australian Securities Exchange (**ASX**) in 2015, and has grown to become one of Australia’s largest mortgage broking groups. Approximately 2,800 brokers arrange residential mortgages, commercial finance and other loan products through AFG.

In February 2016 the Australian Securities & Investments Commission (**ASIC**) issued the *Review of Mortgage Broker Remuneration Structures Scoping Discussion Paper* (the **Scoping Paper**) which notes that the Government had requested ASIC to conduct the review to determine the effect of current remuneration structures on *the quality of consumer outcomes*.

Following an unprecedented data collection process, ASIC released *Report 516: Review of mortgage broker remuneration* in March 2016 (**ASIC Report 516**). That report recognises the important role that mortgage brokers can play in promoting good consumer outcomes and strong competition in the home loan market.[[1]](#footnote-1) It is essential that any actions that follow from ASIC Report 516 do not have the unintended consequences of stifling or inhibiting the mortgage broking industry which will ultimately be to the detriment of all Australian home owners and all Australians who aspire to own their own home.

AFG has been a leading contributor to the conversation about mortgage broker remuneration since the Government first requested ASIC to consider the impact of the current structure on the quality of consumer outcomes in November 2015. ASIC has stated that the aims of its proposals are to “strengthen the positive contribution that brokers provide in this sector”[[2]](#footnote-2) while enhancing:

1. consumer outcomes and competition;
2. the operation of the home loan market more generally; and
3. the trust and confidence that consumers have in brokers.[[3]](#footnote-3)

AFG’s submission is, in every respect, focussed on these outcomes and we ask that Treasury, the Government and ASIC continue to work with the mortgage broking industry to ensure that these outcomes are achieved and the already entrenched economic power of the country’s largest banks is not enhanced at the expense of the mortgage broking industry and the non-major lenders which rely on brokers for the distribution of their products. The loss of the broker based distribution network would put these lenders at a major disadvantage to the large banks and result in a significant reduction in competition in the mortgage sector, to the detriment of consumers.

**ABA Retail Remuneration Review**

Before moving to a detailed consideration of options to strengthen the positive contribution of mortgage brokers with a focus on enhancing consumer outcomes and competition in the home loan market, it is necessary to first address the Australian Bankers’ Association’s Retail Banking Remuneration Review Report which was released in April 2017 (the **ABA Report**) and referenced by ASIC in **Report 516**.

AFG supports the Australian Bankers’ Association (**ABA**) in its aim to encourage banks to stamp out the misselling of the products that they manufacture and from which they generate significant profits. AFG agrees that significant cultural changes are needed in some banks to achieve this aim. However, it is AFG’s contention that the comments in the ABA Report about the mortgage broking industry are misguided and open to allegations of bias or partisanship (as the ABA have commissioned and financed the report and set its terms of reference).

AFG has previously raised concerns about the risk of the ABA sponsored review drawing false conclusions about broker remuneration due to the limited and one-sided nature of the investigations that were undertaken. It is AFG’s view that the failure to include all relevant stakeholders in the development of the ABA Report is so fundamental as to make the associated recommendations nothing more than the opinion of a single interest group with motives that may diverge from the fundamental aims enunciated by ASIC of strengthening the positive contribution of brokers while enhancing consumer outcomes and competition in the home loan market.

For this reason, we urge the Government and Treasury to treat the ABA Report as a submission by just one interest group in the mortgage industry.

**The standard commission model**

It is important to remember that the existing commission model for mortgage brokers is not broken. The existing model means that all Australian borrowers have the option of using a broker or dealing directly with their chosen lender. The development of the mortgage broking industry has increased competition amongst lenders by giving those without a large branch network access to an effective distribution network. AFG has 45 lenders on its panel with more than 34% of borrowings going to lenders other than the four major banks. This competitive tension is needed to help limit oligopoly behaviour in an industry that is dominated by the four major banks.

AFG agrees that borrowers should not be encouraged to borrow more than they require and it is appropriate to consider whether there are any industry structures or features that create a market distortion. AFG is of the view that lenders can reduce this risk to borrowers and improve consumer outcomes by making the following changes to existing commission structures:

1. paying upfront commissions on the drawn-down amount rather than the approved amount (this may necessitate upfront payments being made in tranches, for example for construction loans and lines of credit); and
2. introducing balanced scorecards for brokers that recognise appropriate loan application quality metrics.

These changes should not result in an economic drift away from the broker to the lender as devaluing the service provided by brokers would have significant and long term detrimental effects for consumers by lessening the competitive tensions that currently exist in the credit industry. It is essential that anticompetitive conduct is not permitted to proliferate under the guise of regulatory reform.

In addition, lenders should be encouraged to consider whether their methodologies for pricing loans should be reviewed to reduce the incentive for consumers to take out larger than necessary loans. For example, consumers may borrow more than necessary in order to access additional discounts to the standard interest rate.

AFG is of the view that lenders should be allowed to implement these changes individually and over time in recognition of the system changes that will be required.

AFG does not support the introduction of a standard fixed fee payable by the lender as such an approach would inevitably cause significant market distortions that would lead to a reduction in competition and detrimental consumer outcomes. For example:

* a flat fee would discourage the provision of services by brokers to customers with larger more complex transactions;
* the four major banks with large bank branch networks would have the opportunity to increase their existing oligopoly powers as they would continue to receive the benefits of selling larger loans to consumers (as the product manufacturer); and
* the absence of trail payments would discourage the continuation of an ongoing relationship between the broker and the client and make the relationship more transactional.

**Bonus payments**

AFG agrees that brokers should not be encouraged to select a particular lender in order to reach a volume based bonus threshold. Whether or not this affects any particular decision of a broker, it nevertheless creates a negative perception in the community that should be dispelled. AFG does not pass on volume based incentives to brokers and the comparison software that AFG provides to its broker network does not include paid advertisements or prioritise lenders based on financial incentives.

AFG agrees that it is an appropriate time for the industry to replace existing volume based incentives with payments that are more aligned to positive consumer outcomes and the services that are provided. To this end, AFG intends to work with lenders to develop appropriate metrics to replace existing volume based incentives. It is proposed that these metrics will reflect the quantum of benefit to each individual lender so as not to have a detrimental effect on competition. This work is already underway.

In order to be effective, these changes must also include lender conduct that has the same premise as volume based incentives such as the lender practice of terminating a broker’s accreditation for not achieving volume based hurdles. This practice is clearly as detrimental as the payment of volume based incentives and, in AFG’s opinion, should not be permitted.

**Soft dollar benefits**

AFG supports proposals that enhance the community’s respect for the broking industry. When considering whether it is appropriate to provide a soft dollar benefit, lenders and aggregators should consider whether the proposed benefit is likely to enhance or improve the service provided by the broker to the consumer.

AFG is of the view that this aim is best achieved by focusing expenditure on the provision of education and training to enhance the quality of credit assistance services provided to consumers. AFG continues to focus on the development of systems to improve the delivery of training and education to its credit representatives and intends to encourage lenders to enhance their provision of education and training to brokers.

**Disclosure of ownership structures**

The impact of the vertical integration of mortgage broking businesses is of concern. With two of the major lenders owning a significant portion of the country’s aggregators (CBA/Aussie and NAB/FAST; PLAN; and Choice Aggregation Services[[4]](#footnote-4)) we believe transparency is very important to the integrity of the broker proposition.

AFG supports ASIC’s proposal to require clear disclosure of ownership structures.

**Public reporting**

AFG supports transparency and has publicly released information about the flows of broker business to the lenders on our panel through the AFG Mortgage Index and the AFG Competition Index for many years. Banks that securitise home loans also provide detailed reporting to the RBA with respect to the loans in the securitised loan pool.

With respect to the other information that ASIC has suggested be made publicly available, AFG suggests that in order to ensure the integrity of the data, the required information should always be obtained from the most direct source. This will generally be the credit provider and ASIC could implement a standardised data collection process to collect the required data periodically. Ideally, there would be a transition period to enable credit providers to set up the necessary systems to collect the required data.

**Governance and Oversight**

AFG supports the principle that all industry participants should consider the aim of obtaining good consumer outcomes when designing their arrangements, including remuneration arrangements. AFG is already working to include consumer outcomes as part of its dialogue with lenders.

It is AFG’s recommendation that a working party be established including ASIC, lender and aggregator representation to develop specific recommendations for information that should be provided by all lenders to enable aggregators to better monitor the consumer outcomes achieved by individual brokers.

Unfortunately, suggestions that aggregators should “require” lenders to provide consistent reporting do not take into account commercial reality and the limited negotiating powers of aggregators compared to the major banks.

**Conclusion**

AFG urges the government to act to stop some banks from using the ABA Report and the Government’s recently announced *major bank levy* as a justification to implement changes designed to reduce the financial viability of providing broking services and marginalise large portions of the mortgage broking industry. If such actions prove successful, competitive tensions in the mortgage market would be significantly reduced and the existing oligopoly powers of the four major banks would grow at the expense of consumers, the broking industry and lenders that do not have large branch networks or other mature distribution networks. These outcomes would not be consistent with ASIC’s stated aim to enhance consumer outcomes and competition.[[5]](#footnote-5)

In order to ensure that the mortgage broking industry is able to continue to provide a service that enhances both competition and consumer outcomes, the Government’s new *Banking Executive Accountability Regime* should include appropriate measures for bank executives that prevents them from taking advantage of existing oligopoly powers.

In summary, it is AFG’s submission that all relevant stakeholders should now commence work on a number of projects designed to meet ASIC’s goal of strengthening the positive contribution that brokers provide in this sector. In particular:

1. Lenders should be discouraged from taking any action that has the effect of limiting the ongoing financial viability of mortgage brokers due to the detrimental effect that such conduct would have on competition and consumer outcomes. This should include proposals to replace the current commission model with a flat fee model paid by lenders proposed by the ABA and any proposals that would further cement the competitive advantage enjoyed by the major banks.
2. Individual aggregators and lenders should work together to revise their existing contractual arrangements with a focus on paying up-front commissions based on drawn-down amounts and introducing balanced scorecards for brokers. In addition, lenders should be encouraged to consider whether their methodologies for pricing loans should be reviewed to reduce the incentive for consumers to take out larger than necessary loans. For example, consumers may borrow more than necessary in order to access additional discounts to the standard interest rate.
3. Bonus payments should not be paid to brokers who provide credit assistance to consumers. Aggregators that pass on bonus commissions to brokers should revise those arrangements. Individual aggregators and lenders should work together to develop appropriate metrics for payments (to replace existing volume metrics). Lenders should also be prohibited from using volume metrics as a requirement for accreditation of brokers.
4. When considering whether it is appropriate to provide a soft dollar benefit, lenders and aggregators should consider whether the proposed benefit is likely to enhance or improve the service provided by the broker to the consumer.
5. ASIC’s proposal to require clear disclosure of the ownership structures of vertically integrated businesses should be implemented. The disclosure obligation should result in simple clear disclosure that consumers can easily understand.
6. ASIC should form a working group with lenders, aggregators and brokers to develop a standard set of information that lenders must supply to aggregators. This would assist aggregators to form a better understanding of their brokers’ conduct.
1. Australian Securities & Investments Commission, *Report 516: Review of mortgage broker remuneration*, March 2017, para 19. [↑](#footnote-ref-1)
2. Ibid, para 23. [↑](#footnote-ref-2)
3. Ibid, paras 23-24. [↑](#footnote-ref-3)
4. Ibid, para 291. [↑](#footnote-ref-4)
5. Ibid, para 23. [↑](#footnote-ref-5)