29 June 2017

By Email: consumercredit@treasury.gov.au

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

Dear Sir or Madam,

Australian Securities and Investments Commission (ASIC) Review of Mortgage Broker Remuneration – Consultation Paper dated March 2017

Further to your request for feedback on your consultation paper, Mortgage Choice would like to provide its comments on the findings and proposals outlined in the ASIC Review of Mortgage Broker Remuneration Report 516.

Mortgage Choice

Mortgage Choice Limited is a public company listed on the ASX and is included in the ASX 300. It holds an Australian Credit License to act as a credit intermediary and a wholly owned subsidiary and holds an Australian Financial Services Licence that allows its authorised representatives to provide advice to consumers on Tier 1 products. The company distributes credit advice, primarily on residential lending, and financial planning advice services to consumers through a franchise network of 465 independently owned small businesses across Australia. Mortgage Choice represents a strong financial brand that is well respected in the market and has delivered quality service to consumers for 25 years.

Feedback Executive Summary

We are supportive of ASIC's review of mortgage broker remuneration, governance and oversight arrangements in the context of ensuring these arrangements lead to quality consumer outcomes. This is logical particularly given the mortgage broker industry is now a significant contributor and accounts for over 54% of all home loans written.

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With respect to the six (6) proposals outlined in your report, we offer our thoughts below. In summary, we believe the current standard commission model is sound and delivers positive consumer outcomes. We do not oppose Proposals 2-6 however we do have some concerns in respect of obtaining the level of information required to meet the requirements under Proposals 5 and 6 from our lender partners. We also highlight that, with respect to Proposal 3, we believe Lender Sponsorship and Aggregator conferences and events should not be removed where these are linked to broker professional development. These are essential to the progression and increased professionalism of brokers in our industry.

It is important that the ASIC Broker Remuneration Review is not reviewed in isolation of the ASIC industry funding model. These are inextricably linked and should be considered together to deliver positive consumer outcomes.

Feedback on Proposals

Proposal 1 – Improving the Standard Commission Model

1. The ASIC report has indicated that there appears to be more Interest Only (IO) loans through the broker channel, and the LVRs and loan amounts are higher through this channel. We believe this is due to the demographics of the customers who choose to use a broker and the more complex needs they bring to the table, as well as brokers actively looking for solutions that meet their customers long term needs. For instance a broker may ask a customer what the long term strategy is for the property they are looking to purchase and will look to structure the loan with that in mind, which could result in IO being the best long term option for the customer. We do not believe that brokers, in general, place loans with the sole intent and purpose of receiving additional commission.

2. We believe the current, standard commission model is sound and delivers positive consumer outcomes. The upfront commission structure appropriately compensates the broker for the time and effort required to lodge an application and take it through to approval. The time and effort involved in this process is significant, it requires the broker to forensically assess the customer's needs, future needs, income, asset position as well as living expenses, review the current offerings in the market and match the same with a suitable solution. The payment of trail commission encourages the broker to put the customer in a product that will be suitable for the consumer over the long term. Interestingly, the shape and the quantum of initial and ongoing commission is similar to the commission structures to be adopted in the Life Insurance industry.

3. It is Mortgage Choice's position that if ASIC wishes to change the shape and nature of mortgage lending through broking or through the lending system then there are two significant levers that need to be used: lender credit policy and lender pricing. Influencing lender credit policy would ensure borrowing levels are appropriate based on servicing, LVR and repayment restructure (IO vs P&I). By varying lender policy, the regulator can essentially adjust the loan portfolio characteristics. Pricing to consumers already does influence the shape and nature of

mortgage lending. Differential pricing based on lender preferences and lender risk is already prevalent in the market. Lender pricing of loans may vary by 0.10% or 0.15% for loans in an LVR band of 95% as compared to those at 75%. This drives consumer behaviours to seek lower LVRs and the associated discounts. Brokers work with borrowers to obtain the most cost effective lending solution. To suggest that a Broker would encourage a customer to borrow more or to borrow at a higher LVR would not be an effective business outcome for a broker who would very easily lose a customer relationship if they did not find a competitively priced lending solution. Furthermore, lender pricing to consumers follows the economics of lending in that the larger the loan the larger the profit for the lender and as such, lenders typically offer larger drive discounts for larger loans. Accordingly, in certain situations, customers' needs may be well served if they were to borrow just enough to cross the next pricing tier and then place the additional funds in an offset account.

4. To suggest that it would be effective to change the shape or quantum of broker commissions based on LVR, interest-only or lower loan amounts would not be correct. Broker economics need to line up with lender economics and consumer outcomes. Markets already price for risk and return driving both lower LVRs and higher loan amounts through discount pricing to the end customer. Unless the regulator is intent on dictating the discounting regimes set by lenders, then the only truly effective mechanism available to the regulator is through being more prescriptive in lender underwriting policy or shaping the economics at the lender end to drive an increase in consumer pricing at the higher risk end of the market.

Proposal 2 – Moving away from bonus commissions and bonus payments

1. In respect of Mortgage Choice, we do not believe these types of payments are a significant influencer in terms of where a broker places the business on behalf of a customer. Our 'Paid the Same' model means regardless of which lender a customer chooses, as long as it is a residential loan from our panel of lenders, any such payments are pooled and shared with brokers based on the volume of business they write across the entire lender panel. There is therefore, no individual financial benefit in placing a deal with one lender over another.

2. Mortgage Choice only receive such payments from two lenders and the amount is not significant. These payments are also pooled and shared with brokers based on the volume of business they write across the lender panel. We note bonus commissions and bonus payments were removed from the Financial Planning industry as part of FOFA reforms, and are now being removed from the life insurance industry. For consistency in application, we are not opposed to the removal of these payments in the Mortgage Broking industry.

Proposal 3 – Moving away from soft dollar benefits

1. We are supportive of the removal of soft dollar benefits as they could be influential to brokers and divert business from one lender to another. We support transparency in relation to all commissions paid.

2. We are not opposed to brokers being provided hospitality benefits such as tickets to sporting events or concerts however any such benefits should be advised to the Aggregator business in order to maintain broker records and enable appropriate monitoring. This would include the details of the broker attending, the event, cost and date of event.

<u>Proposal 4 – Clearer disclosure of ownership structures.</u>

1. Mortgage Choice is comfortable with this proposal and has no feedback other than the request for guidance on the level of detail required in the disclosure. For instance, is disclosure required in respect of an investor (eg lender) who holds a minor stake (eg 50% or less and no influence on the company's board) in an Aggregation business?

<u>Proposal 5 – A new public reporting regime.</u>

1. We are comfortable with this proposal however it is important to note that implementation by Aggregators is reliant on the quality and quantity of lender reporting. The information currently provided by a lender is generally at an aggregated level it is not loan, customer or broker specific. This will need to be addressed to accurately report as proposed.

<u>Proposal 6 – Governance and oversight.</u>

1. We are comfortable with this proposal however as stated above our ability to meet the requirements for oversight of brokers will be dependent on the ability of the lender to provide such information at a loan, customer and broker level. Some lenders may have difficulty extracting and providing such data especially if they operate on older platforms and systems.

2. Our overall view is that we are supportive of ASIC's recommendation - promoting a strong governance and oversight structure is in the best interests of consumers and the viability of the industry as a whole. Mortgage Choice has a strong Compliance Framework and invests heavily in ensuring our credit representatives are monitored to meet lending standards. Ensuring a company has responsibility for governance and oversight is critical to providing good customer outcomes.

3. We therefore believe it is important that the ASIC Broker Remuneration Review is not reviewed in isolation of the ASIC industry funding model. These are inextricably linked and should be considered together to deliver positive consumer outcomes. While law has been passed in respect of the Levy, we offer our views on how the funding model impacts governance and oversight, and the need for appropriate incentive at the corporate level to maintain compliance structures.

4. With respect to the funding model, the principle should be that those that necessitate ASIC activity should bear the cost of that activity. This activity includes:
   - Surveillance
   - Monitoring
   - Enforcement

5. If the charging mechanism (levy) is on the basis of a flat fee per CRN it is less viable for organisations such as Mortgage Choice to continue to invest in their own compliance frameworks. Continuing to invest, when others do not, will place companies such as ours at an economic disadvantage. Existing internal frameworks are focused on ensuring Credit Representatives meet lending standards, complaint management processes and regulatory requirements. Managing an effective compliance framework internally reduces the likelihood and number of customer-related complaints, and any resulting enforcement activities. Mortgage Choice invests over $1m per annum on a risk and compliance framework, 70% of which is for our credit intermediary/ broking business and the remaining 30% attributable to our Financial Planning Business in the Financial Advice sector. In the past five years, we have had less than 15 cases referred to CIO/ COSL for the broking business and all the referred cases were found in our favour.

6. Alternatively, companies such as ours could pass on the cost of internal compliance to its Credit Representatives, resulting in these companies becoming more expensive and therefore uncompetitive vis a vis other aggregation businesses that do not undertake internal compliance monitoring.

7. If there is no financial value attached to internal compliance frameworks, those CRNs driven by economics are likely to take on their own ACL resulting in a proliferation of ACL holders in the industry. This will reduce industry standards as these individuals will be 'marking their own homework', which will ultimately increase the level of ASIC involvement and cost of surveillance and enforcement, which is not cost effective. Further as the complexity of lending increases, with little or no compliance framework to oversee credit representatives on a day-to-day basis, there will be a reduction in the quality of consumer outcomes. These smaller ACL holders are also unlikely to have the capital structure to support payment of any enforcement activities, adding this financial burden onto the industry.

8. If ASIC choose to retain the proposed minimum and graduated fee structure, a suggestion would be to discount the fees based on evidence of there being a compliance framework in place with internal or external auditing. For example in our Mortgage Choice Financial Planning business, we have commissioned two external Licensee Compliance Audits in the first five years of operation. Annual external audits are also conducted across our authorised representative network. This investment in external audit services should be acknowledged and taken into account in calculating the levies. This will serve as a powerful incentive for a company to invest in a robust compliance framework and reward those companies that do.

9. The proposed funding model seeks to impose a higher levy on listed companies than unlisted companies. From a competitive and financial perspective this disadvantages organisations such as ourselves, who are listed, and compete with organisations which are unlisted (for example Connective). This does not create a level playing field and discourages competition in the market.

We appreciate this opportunity to participate in the consultation process and would be available to discuss any of the information provided in more detail.

Yours faithfully,
MORTGAGE CHOICE LIMITED

DAVID HOSKINS
COMPANY SECRETARY

cc John Flavell, CEO