NATIONAL AUSTRALIA BANK SUBMISSION

ASIC Review of Mortgage Broker Remuneration

30 June 2017

Overview

National Australia Bank (NAB) welcomes the opportunity to provide feedback on the proposals identified in the ASIC Review of Mortgage Broker Remuneration. As a member of the Australian Bankers' Association (ABA) and the Mortgage & Finance Association of Australia (MFAA), NAB has also contributed to and is supportive of their respective submissions to this consultation.

ASIC's review was a detailed examination of the sector. As part of the review, NAB provided ASIC with information on more than 360,000 residential mortgages from 2012 to 2015 and answered more than 13,000 questions in relation to lending and aggregation. NAB notes and supports ASIC's observation that "brokers can play an important role in promoting good consumer outcomes and strong competition in the home loan market."[1]

Concurrently with ASIC's review, NAB also participated in the ABA initiated review of product-based commissions and payments in retail and small business banking, conducted by independent reviewer Stephen Sedgwick AO. Six of Mr Sedgwick's 20 recommendations related to third parties (mortgage brokers and introducers).

While this response will focus on ASIC's proposal for mortgage broker remuneration, throughout this submission NAB has highlighted where ASIC's proposals interact with mortgage broker-related recommendations from the Sedgwick Review. The responses should be read noting NAB's commitment to implementing the final recommendations from Mr Sedgwick, including those relating to third parties, by 2020.

Any reference to "NAB" includes the views of NAB, and its owned businesses Advantedge, and aggregators: PLAN Australia (PLAN); Choice Aggregation Services (Choice); and FAST.

NAB broadly supports ASIC's proposals

In broad terms, NAB supports ASIC's six proposals and believes they can "improve the trust and confidence that consumers can have in brokers".[2] By supporting these proposals, NAB believes the industry can evolve quickly, and through self-regulation, continue to build trust with all stakeholders, including customers.

NAB considers the following principles should underpin any changes to mortgage broker practices (particularly for remuneration and governance):

- Reduce the risk of poor consumer outcomes;
- Recognise the work effort of brokers;
- Ensure competition is maintained in the market; and
- Be easy to disclose and simple for customers to understand.

We are also broadly supportive of the MFAA's guiding principles detailed in their submission to the Department of Treasury.

Any changes need to be considered so as not to create unintended consequences of restricting the provision of credit for certain segments of the market, such as first time buyers.

Approximately 16,000 mortgage brokers operate in the market, many of whom are small business owners who form a significant and important part of the economy. NAB agrees with Mr Sedgwick that any changes to mortgage broker remuneration must ensure the industry remains viable and competitive.[3]

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[1] ASIC Report 516, 'Review of mortgage broker remuneration', section 20, p8.
[2] ASIC Report 516, 'Review of mortgage broker remuneration', section 24, p9.
[3] Retail Banking Remuneration Review, Stephen Sedgwick AO, 19 April 2017, p10-11.

The implementation of ASIC's proposals require further consultation with the industry and regulators. NAB believes this consultation is an important part of that process. NAB participated in the first of these discussions on 9 June 2017, with key industry participants including members of the ABA, MFAA, the Finance Brokers Association of Australia (FBAA), the Customer Owned Banking Association (COBA), non-bank lenders, aggregators and brokers to progress reform and we look forward to further discussions.[4]

NAB's involvement in the mortgage broker sector

NAB participates in the sector in both lending and aggregation. Generally, brokers have a contractual legal relationship with their aggregator, who in turn has a legal agreement in place with the lenders on the aggregator's panel. There is no direct legal contractual relationship between the broker and the panel lender.

NAB is a lender of mortgages sold by individual mortgage brokers to consumers, and also distributes white label mortgages through a NAB-owned business, Advantedge. Advantedge provides white label branded mortgages available for distribution through those aggregators' brokers.

As noted by ASIC, NAB also has full-ownership of three aggregators, PLAN, Choice and FAST. PLAN, Choice and FAST support and work with over 4,500 brokers by providing access to:

- A broad panel of lenders and products;
- Systems and technology;
- Support with professional and business development; and
- Assistance with licensing and compliance.

NAB's ownership of PLAN, Choice and FAST ensures these brokers receive the benefits of NAB's continued investment in aggregator systems and processes to support brokers running their businesses. Through PLAN, Choice and FAST customers who use the services of brokers through these aggregators have access to a diverse panel of approximately 40 lenders.

NAB, including each owned aggregator, has rigorous processes to manage conflicts, and perceived conflicts, to protect the interests of customers and brokers. Individual brokers who aggregate with PLAN, Choice or FAST are not employees of NAB.[5]

PLAN, Choice and FAST allow their brokers to hold their own Australian Credit Licence (ACL) or apply to be authorised to engage in credit activities as a Credit Representative of BLSSA Pty Ltd (BLSSA), another wholly owned NAB Group entity and an ACL holder. Through BLSSA, NAB is the largest provider of licence and compliance services to brokers in Australia. Brokers appointed as BLSSA's Credit Representatives can provide mortgage broking services to consumers using BLSSA's accreditation.

ASIC's report made some specific comments in relation to NAB and its participation in the mortgage broking market. NAB would like to comment on these specifically, in addition to providing views on ASIC's six proposals.

ASIC's report[6] notes the percentage of an aggregator's loan flow (by value) sent to a lender which they are either partially or fully owned by. For the NAB-owned aggregators PLAN, FAST and Choice, the percentage of loan flow sent to NAB was similar to overall market share within the broker channel, excluding white label loans. When including white label loans though, the percentage of aggregator loan flow to NAB was higher than NAB's overall market broker share.

[4] See Joint press release from the ABA, MFAA, FBAA and COBA, Wednesday 14 June for further information.
[5] All brokers are independent to NAB with the exception of circa 17 brokers employed through PLAN Australia, who offer an in-house mortgage broking service via MLC Mortgage Solutions for financial advisors.
[6] ASIC Report 516, 'Review of mortgage broker remuneration', p151.

NAB believes there are many valid reasons for this difference which include:

- A white label mortgage is a simple lending product, offering consumers an alternative to other products in the market. It offers high quality service, a competitive lending rate and low fees for customers. This combination gains support from brokers when meeting the needs of more price sensitive consumers;
- Within PLAN, Choice and FAST, these are mature products that have been offered to customers via brokers since 2009. Over the last few years, the white label lending market has grown significantly including the volumes of white label product sold by Advantedge through non-aligned mortgage aggregators since their launch in 2014; and
- Mortgage market share and flow respond to pricing, changes in market conditions, service and other factors.

Response to ASIC proposals

ASIC Proposal 1: Improving the standard commission model

The standard commission model of upfront and trail commissions could encourage brokers to place consumers in larger loans, even when this may not be in the interests of the consumer. To reduce the risk of this occurring, we propose that lenders change their standard commission arrangements so that brokers are not incentivised purely on the size of loan.

As a lender, NAB currently remunerates brokers with the payment of an upfront commission and then ongoing trail commission. As at 30 June 2017, for NAB-branded products, all brokers receive an upfront commission rate of 0.65% of the loan amount and ongoing trail commission which increases from years three to five of a loan term. For Advantedge (NAB's white label product), all brokers receive an upfront commission of 0.70% of the loan amount and an ongoing trail commission of 0.15% per annum.

In making commission payments, NAB, as the lender, is remunerating mortgage brokers for the work they do as a credit assistance provider, operating under a licence.

NAB's consideration of improvements to the remuneration model is guided by the principles detailed in the introduction and ASIC's observations made in relation to the size of commission payments no longer being purely determined by loan size.

NAB agrees with ASIC that lenders should not "structure their incentives in a way that encourages the creation of larger loans that initially have large offset balances"[7] and believes the industry should make the following adjustments to the standard upfront commission model for brokers:[8]

- Paying upfront commissions based on the amount drawn down to the customer, not the total facility amount; and
- Paying upfront commission net of offset account balances.

NAB supports these changes and will work through the requirements to implement them. These are important improvements that NAB believes should be applied broadly across the industry.

Recommendation 18 from the Sedgwick Review says "banks should adopt approaches to the remuneration of Aggregators and Mortgage Brokers that do not directly link payments to loan size and reflects a holistic approach to performance management". NAB believes there is a direct link between holistic performance management and proposal six (see page 9). NAB will continue to work with the industry on sustainable models for mortgage broker remuneration that do not directly link remuneration payments purely to loan size. This will help mitigate the potential risk that customers are placed in larger loans that may not be in their best interest. NAB would

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[7] ASIC Report 516, 'Review of mortgage broker remuneration', section 116, p24.
[8] NAB notes that trail commission is already paid on both of these terms.

welcome further consultation with the Department of Treasury (Treasury) on this work with the industry.

In relation to the suggestion by ASIC that lenders consider using a Loan to Value (LVR) ratio to determine the size of commission payments, NAB holds concerns about this methodology. Paying commission based on the LVR of a loan could have unintended consequences on market segments that naturally have a higher LVR for valid reasons (such as first time buyers). Additionally, commission based on LVR could lead to lending amounts crowded around the LVR thresholds set by lenders, thus increasing risk for borrowers and lenders at these thresholds.

We also note that NAB, through its ownership of PLAN, Choice and FAST, receives commission payments from all lenders who are on the panels of these three aggregators. Commission rates are based on commercial arrangements set by lenders individually. PLAN, Choice and FAST, on behalf of lenders, then pay brokers' commissions retaining a portion or charging a fee which enables the fulfilment of aggregation services including licensing, professional development and technology to brokers. PLAN, Choice and FAST as aggregators support changes to the calculation of commissions that would improve consumer outcomes in line with the principles outlined on page 2.

ASIC Proposal 2: Moving away from bonus commissions and bonus payments

While bonus commissions and bonus payments do not necessarily cause poor consumer outcomes, they are a form of remuneration structure that creates a higher risk that brokers will place consumers with lenders for the wrong reasons…. Accordingly, we propose that the industry moves away from bonus commissions and bonus payments. The ABA review provides an opportunity for the banking industry to act on this proposal.

NAB agrees with ASIC that bonus commission or payments related to residential mortgages that arise as a result of time-limited campaigns, or broker settlements reaching defined volumed thresholds, create a potential incentive for brokers to not act in the best interests of customers. Customers should know who is getting paid by whom and how much. Bonus components for individual mortgages lack transparency and are difficult for consumers to understand. They also have the potential to distort lending flow.

NAB does not pay volume based incentives on residential mortgages to mortgage brokers. NAB encourages other lenders to adopt a similar stance.

Similarly, aggregators PLAN, Choice and FAST support the proposal to move away from volume based incentives paid to brokers for mortgage lending. NAB encourages the broader mortgage industry to follow this approach.

In response to this proposal, NAB also notes Mr Sedgwick's recommendation 16 in respect of Mortgage Brokers, that:
"a. Banks cease the practice of providing volume based incentives that are additional to upfront and trail commissions; and
c. Banks cease the practice of increasing the incentives payable to brokers when engaging in sales campaigns."

ASIC Proposal 3: Moving away from soft dollar benefits

> Soft dollar benefits also increase the risk of poor consumer outcomes. Like bonus commissions, soft dollar benefits have been prohibited in other parts of the financial services industry under the Future of Financial Advice (FOFA) reforms. We therefore propose that the industry moves away from giving soft dollar benefits.

ASIC defines soft dollar benefits as "any rewards that are not cash".[9] ASIC identifies four primary ways brokers receive soft dollar benefits: broker clubs, conferences and courses, competitions and hospitality. NAB as a lender and aggregator does not provide soft dollar benefits to brokers that are linked to individual lender volumes.

From time to time, NAB as a lender will provide hospitality to aggregators and brokers. Conflicts registers are held by lenders, aggregators and some brokers. NAB considers that brokers should be required to maintain a conflicts register for all soft dollar benefits they receive from lenders. NAB believes that across the industry these broker conflicts of interest registers should be monitored, managed and audited by aggregators as part of their role in monitoring brokers. This register should be made available to customers on request. A uniform approach across the industry for brokers should be adopted. We note in most cases brokers are required to maintain a gifts register.

For brokers, such a Gifts and Conflicts Register would be similar to the one NAB requires employees to maintain. For NAB employees, details of gifts above $300 in value must be registered. Once registered, a NAB employee's manager will then approve before their staff member offers or accept gifts or entertainment.

Further comments on each type of soft dollar benefit are detailed below.

<u>Broker Clubs</u>
As a lender, NAB does not run broker clubs which result in monetary benefits or incentives being paid to brokers. Brokers who aggregate under PLAN, Choice or FAST may have access to such clubs run by other lenders.

NAB believes mortgage brokers should be able to seek assistance from NAB staff who perform credit assessment on the loans that brokers put forward as lending applications on behalf of customers. NAB offers a Premium Access program which provides certain brokers' access to credit coaches for NAB branded mortgages. Eligibility for the program is presently based on a broker's potential overall market level of activity. This is reviewed quarterly, where ongoing access requires meeting quality metrics and utilisation of the service. NAB believes that any service, based on application quality and supporting positive customer outcomes, should be permitted.

Again, NAB's approach also considers Sedgwick's recommendation 16 in respect of Mortgage Brokers, that:
"b. Banks cease non-transparent soft dollar payments in favour of more transparent methods to support training."

With respect to training events, PLAN, Choice and FAST have historically segmented brokers based on overall business volume as well as other qualitative criteria (which is not lender specific). Such events have a strong educational/business development component and NAB believes these events are important to maintain.

[9] ASIC Report 516, 'Review of mortgage broker remuneration', section 612, p113.

Courses and conferences

I. Lender

Conferences are generally provided by aggregators on behalf of their brokers. NAB, as a lender, believes that ongoing education and professional development for mortgage brokers is vitally important. This helps brokers maintain their skills, enhance their product and industry knowledge and keep up-to-date with the latest consumer trends. Professional development activities, such as conferences, also offer opportunities for brokers to grow their business through networking, continued education and access to industry leaders and speakers. It also offers lenders the platform to broadly communicate product enhancements or improvements to their service offering to a large number of brokers. This benefits customers by improving broker knowledge of product specifications.

NAB pays sponsorship to non-NAB owned aggregators for conferences and professional development. Without sponsorship, many of these events would not be able to take place. NAB has recently made changes to stipulate to aggregators what the sponsorship funds should be used for.

With regard to NAB employees attending mortgage broker conferences; NAB employees are only permitted to attend mortgage-broker conferences which include a clear and substantial education component, including the opportunity to earn Continuing Professional Development (CPD) points.

II. Aggregator

It is vital to provide broker members with professional development and training. PLAN, Choice and FAST receive funding, from lenders other than NAB, to help fund these events.

Brokers are required to be a member of a professional body and complete certain CPD hours each year. It is the role of an aggregator to facilitate this. To achieve this PLAN, Choice and FAST hold professional development days and conferences which are often funded via 'sponsorship' or 'investment' from lenders.

Conferences conducted offer relevant material, contain a substantial education component and are conducted in line with community expectations. PLAN, Choice and FAST continue to be committed to providing the highest level of professional development for their broker members. Conferences hosted by PLAN, Choice and FAST are lender agnostic and there is never qualifying criteria for broker attendance based on the volume of a specific lender's loans a broker has written.

NAB is also committed to ongoing assessment of criteria for attendance at PLAN, Choice and FAST aggregator conferences and believes that attendance should not be purely based on the volume of loans written.

Competitions

NAB, either as a lender or aggregator, does not hold competitions where the prize is contingent on sales volumes or for the monetary or non-monetary benefit of brokers. Aggregators should be required to direct their brokers not to participate in those competitions.

Hospitality

ASIC's report[10] states that "small offers of hospitality are unlikely to influence a broker's product recommendations". Similar to conferences, NAB is committed to ensuring incidental hospitality is provided based on criteria including customer outcomes, rather than solely sales volumes.

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[10] ASIC Report 516, 'Review of mortgage broker remuneration', section 676, p125.

ASIC Proposal 4: Clearer disclosure of ownership structures

To reduce the impact of ownership structures on competition in the home loan market, we propose that participants in the industry more clearly disclose their ownership structures.

NAB supports increased disclosure of ownership structures. A strong and diverse mortgage broking industry is in the best interests of customers. NAB agrees with ASIC that the disclosure of commissions, other incentives and other relationships to customers must be clear. Customers should at all times be able to calculate and understand exactly what is being paid to any third party and by whom. NAB believes this proposal should apply to all participants in the home loan market.

In March 2017, prior to the release of ASIC's report, NAB updated its Credit Guide template, (which is utilised by brokers associated with the Choice, FAST and PLAN aggregators), to clearly disclose NAB's ownership of the aggregators and their respective white label lending products. NAB will continue to work with ASIC and Treasury to ensure disclosure of its interests in the aggregators is clear and understood by customers.

ASIC Proposal 5: A new public reporting regime

Establishing a new public reporting regime of consumer outcomes and competition in the home loan market.

NAB agrees in principle that information relating to the home loan market should be publicly available to the industry. NAB currently provides, or information is provided by others on NAB's performance, via:

- The NAB Property Report (a service available to customers to obtain information about their prospective property purchase);
- Monthly APRA reporting on loan volumes; and
- Roy Morgan customer satisfaction and Net Promoter Score (NPS) research.

NAB encourages further public reporting to also include qualitative measures such as service and market specialisation (investor, owner-occupier, location) that are also tied to customer outcomes, rather than being solely focused on average home loan pricing.

When implementing such a regime, NAB believes the following principles should be considered:

- Respect consumers' choice of lender and service channel;
- Provide qualitative and quantitative information to consumers beyond price;
- Be feasible to implement for all customer types and loans across all channels;
- Be simple for a customer to understand; and
- Any information reported should be available electronically and be easily accessible for consumers.

NAB urges caution in some of the specific criteria ASIC recommended be publicly reported, in particular, the average prices of home loans. Pricing is dependent on a range of factors, such as the types of customers, loan purpose and repayment type (e.g. interest only or principal and interest). Comparing this data may prove problematic as each broker will have particular markets they operate in.

Further, any reporting needs to be considered at a practical level. For example, obtaining information proposed by ASIC from individual brokers may be challenging, time-consuming and potentially add cost to the system without commensurate benefits.

NAB believes a reporting regime requires the support of the industry to be successfully and consistently implemented and looks forward to working further with industry participants to obtain this support. NAB also encourages this proposal to be considered in the context of the other proposals, particularly improvements to governance proposed in respect to ASIC Proposal 6.

ASIC Proposal 6: Governance and oversight

Improving the oversight of brokers by lenders and aggregators.

NAB supports improved oversight of brokers, both as a lender and an aggregator. For any additional oversight measures there should be clear delineation between the requirements of brokers, aggregators and lenders to avoid duplication and overlap. Each of these entities should have clearly defined and different responsibilities, reflecting their different roles.

NAB believes aggregators will be important in providing this governance and oversight of the operations and activities of their associated brokers. This would require aggregators to provide lenders with key information on oversight activities. All aggregators, including PLAN, Choice and FAST, would benefit from providing greater oversight of brokers to ensure this occurs. NAB considers these changes will require further work with aggregators to determine how this could occur and be funded. Lenders will also need to provide aggregators with data at a broker level.

Overall, NAB believes an industry standard is needed to ensure consistency across the industry in relation to governance and oversight.

Two areas NAB believes are important in any oversight model are:

- Responsible lending; and
- Reporting of ACLs and brokers in the market regardless of their licensing arrangements.

Responsible Lending

NAB believes proposal six enables another way of ensuring that industry participants are following responsible lending principles and thereby supporting good customer outcomes.

Currently, lenders rely on the mortgage broker to document the initial discussions between the mortgage broker and the consumer, but lenders are accountable for ensuring the product provided to the consumer is 'not unsuitable' according to the NCCP Act. At the assessment of a mortgage loan application, lenders generally only receive the application data required to assess the credit application and if a loan is 'not unsuitable' for a consumer. Lenders are not given any direct record of the conversation between the consumer and the broker.

NAB encourages all aggregators to increase their level of oversight on their respective brokers performing adequate 'Preliminary Assessments' as holders of credit license arrangements. NAB will increase oversight on all aggregators, it deals with as a lender, to assist with ensuring brokers perform preliminary assessments thoroughly. To ensure lenders are comfortable with the quality of the initial discussions, lenders should be able to access preliminary assessments as, and when, they need to. Further, as brokers maintain the face-to-face relationships with customers it is important that brokers capture these discussions and be able to evidence they are complying with responsible lending obligations appropriately, both at the point of sale and an ongoing basis.

Aggregators need greater oversight of brokers to ensure brokers continue to be accessible to customers, who settled loans with credit assistance provided by those brokers, and lenders need visibility of this oversight.

Today, trailing commissions are generally paid as a percentage of the loan balance and generally cease if loan payments fall 90 days past due.

One option to help meet Mr Sedgwick's recommendation 17 that "Banks adopt… an 'end to end' approach to the governance of mortgage brokers that approximates as closely as possible a holistic approach to that proposed for the performance management of equivalent retail bank staff", is the potential to attach other key performance indicators (KPIs) to the payment of trail commission going forward. These could include evidence of good quality 'preliminary assessments' and, where appropriate, ongoing service being provided to the customer to ensure all parties are aware of any change in the customer's circumstances, requirements or objectives. The purpose of this change would be to ensure customers receive a positive outcome at the time of initial finance and on an ongoing basis.

Reporting of ACLs and brokers
Any governance regime needs to consider the reporting to ASIC by lenders and aggregators of cases of alleged misconduct by mortgage brokers to assist in encouraging positive consumer outcomes and consistent industry practices.

NAB has made submissions to ASIC Consultation Paper 281 Financial Services Panel and to the ASIC Enforcement Taskforce's Review on self-reporting of contraventions by financial services and credit licensees. Any governance model needs to ensure it aligns with changes from these concurrent proposals.

Notwithstanding these pending proposed changes; NAB is working to improve how cases of alleged broker misconduct for PLAN, Choice and FAST are managed. NAB's work on this area is focused on instances where:

- A broker is not a credit representative under the BLSSA framework; and
- A broker may be under investigation by one, but not all lenders, on an aggregator's panel to ensure a consistent methodology is applied and natural justice is afforded to brokers.

Further, NAB supports the recently announced conduct background check by the ABA.[11] NAB will implement this change by 1 July 2017. Pending successful implementation of the protocol, NAB believes consideration should be given to expanding its scope beyond bank employees, to groups such as mortgage brokers in the future.

[11] See 9 June 2017 ABA announcement: "Banks crackdown to private finance sector misconduct".