2 March 2016

Australian Securities and Investments Commission
GPO Box 9827
Sydney NSW 2001

By email:

Dear Sir/Madam,

Response to the Review of Mortgage Broker Remuneration Structures Scoping Discussion Paper

The Mortgage and Finance Association of Australia (MFAA) welcomes the opportunity to respond in respect to the subject matter of the Review of Mortgage Broker Remuneration Structures Scoping Discussion Paper (Scope) prepared and circulated in February 2015. Our comments below are made in relation to the MFAA's view of the Scoping Considerations and Scoping Questions set out in the discussion paper.

Established in 1982, the MFAA is the peak professional body providing service and representation for more than 12,000 professional finance brokers (mortgage and finance brokers and intermediaries, mortgage management businesses, non-bank lenders and aggregators) to assist them to develop, foster and promote the mortgage and finance industry in Australia. Its membership profile also includes ADI lending institutions that distribute their products via intermediaries, and businesses that provide support services to the mortgage and finance sector.

The business of assisting people in securing suitable financing for real estate and providing long-term professional service throughout the life of a customer's loan brings with it professional obligations to act honestly and ethically. The MFAA has a strict code of practice and ethics attached to its membership. This is most clearly demonstrated through the published suspension or expulsion of 47 members who have been found by the MFAA Tribunal to have breached that Code of Practice over the past five years.

We thank ASIC for the opportunity to contribute on the subject matter of the Review of Mortgage Broker Remuneration Structures Scoping Discussion Paper. Given the feedback requested by ASIC, our comments are solely focused on the MFAA assessing the suitability of the scope outlined in the discussion paper in relation to the home lending market, remuneration structures and consumer outcomes.

The MFAA is committed to ensuring its members act in accordance with industry regulation and would be pleased to continue working with ASIC in providing further feedback and analysis as required in the Review of Mortgage Broker Remuneration Structures.

Should you have any queries in relation to this submission, please do not hesitate to contact the MFAA's CEO, Siobhan Hayden on 0405 182 591.

Yours sincerely

Siobhan Hayden
CEO

Introduction

The home lending industry plays a significant role in the Australian economy. As previously outlined by Peter Kell, Deputy Chairman of ASIC, there are significant differences between the commission structures of financial planners and mortgage brokers. The structure of mortgage broker commissions are structured in a way that ensures the broker provides professional services and assistance for the life of the loan. If a loan goes into default, there are remuneration consequences for the broker such as commission claw-back to ensure consumers are offered the most suitable long term product at the time of application.

Mortgage brokers settled 51.8% of new residential homes in 2015, an increase from 50.4% in 2014. The continued year on year growth (2.5%) in the mortgage broker market share indicates that the consumer sees value in partnering with a mortgage broker instead of a traditional bank when deciding how to secure finance.

Prior to the de-regulation of the Australian financial system in the 1980's, loan origination generally occurred directly at branches of the major banks and building societies. Since de-regulation there have been widespread bank branch closures and rationalization. In response to these changes the mortgage broking industry has grown significantly.

Mortgage brokers have become an effective method of originating loans for lenders, particularly those smaller lenders without the balance sheet to support a branch network.

At the same time, mortgage brokers have become popular with borrowers by providing a convenient service that assists them to find a mortgage product that meets their needs from the range of products available that they may otherwise not have access to.

Within the mortgage broking industry there are a number of different operating models, including;

- Wholesale Mortgage/Broker Model,
- Franchisee Model,
- Licensee Model,
- Sole Trader

The services of mortgage brokers and wholesale mortgage brokers are increasingly important in the Australian mortgage landscape.

Scoping Considerations – Participants and the roles – the role of brokers and other participants involve in the distribution of home lending products.

The Home Lending Market value chain in Australia, can be divided into three (3) broad categories;

- Origination
- Servicing
- Funding

As an industry association, the MFAA represents three key pillars; professionalism, ethics and education. This means that any finance broker that holds MFAA membership adheres to a code of conduct. The MFAA provides resources and guidance to borrowers, helping them make informed choices during their lending and investment journey.

The MFAA works in partnership with the diverse range of industry participants, as identified by ASIC in their Scope across all three categories to ensure;

- Management of annual member compliance (AML/CTF/CPD),
- Industry advocacy and adherence to a Code of Conduct,

- Provision of Continual Professional Development (CPD) opportunities,
- Access to broader business & skills development opportunities, and
- Member reward & recognition.

Should any MFAA member not conform to this code of conduct and fail to provide a service which is professional or legally compliant, the MFAA will assess that adviser's membership through the MFAA Tribunal. The Tribunal is run independently of the Association. The Tribunal provides the Association with their findings and recommendations and where brokers are found to be guilty of misconduct, they will either be suspended or expelled from the MFAA.

The MFAA would like to highlight that the Scope should include all participants that have the opportunity to be financially compensated for their involvement in the Australian home lending market. It notes that currently; credit repair agents, mortgage introducers, new property sales (spruikers) and solicitor funding providers often receive a benefit from their involvement in the market without regulation or declaration of interest.

Distribution channels

Mortgage brokers settled just under 52% of all new residential homes in Australia, in December 2015. A mortgage is a long-term commitment which can span 20-30 years, and many home buyers prefer to be reassured by a mortgage broker who is independent of any one lender that the mortgage product they choose is right for them. Mortgage brokers provide a benefit to both lenders and borrowers.

Mortgage brokers benefit lenders by:

- Providing a distribution network without lenders having to invest in branches and other physical infrastructure (particularly important following industry wide branch closures and rationalisation);
- Allowing lenders to differentiate their products to capture a different segment of the mortgage market; and
- In the case of wholesale mortgage brokers, managing a large volume of mortgage brokers on a day to day basis and therefore reducing the Lender's fixed costs. Management of a mortgage broker may encompass compliance, training, and distribution of revised and new product details and also payment of remuneration for all settled loans.

Mortgage brokers benefit borrowers (consumer) by:

- One point of contact in the loan origination process, saving time and reducing the administrative burden on the borrower;
- Large mortgage broker networks that provide opportunities to extract competitive loan pricing and terms from Lenders;
- A customised approach to each individual borrower's needs;
- Flexibility and convenience in being able to talk to a mortgage broker outside bank opening hours; and
- Advice on a wide range of lending products that may otherwise be difficult to source.

Lenders usually pay upfront and/or trail commissions in respect of the loans, mortgage brokers originate. The upfront remuneration offered by lenders is mostly uniform at 0.65%, and trail remuneration also uniform at 0.15% for the life of the loan. Lenders vary in their application of claw-back, ranging from 12-24 month terms as well as their introduction of trail payments (delayed until the 13mth).

The MFAA would like to note that broker remuneration provided by lenders has reduced over the past ten (10) years from a mostly uniform offering of 0.70% and 0.25% for upfront and trail commissions

respectively. In parallel, broker costs, compliance requirements and client engagement per file have all increased. The MFAA also notes that residential mortgage brokers generally do not charge borrowers an upfront service fee.

The MFAA is aware of a few key lender products that require additional accreditation and/or offer dissimilar commission structures, such as Reverse Mortgages, Self-Managed Super Funds (SMSF) and Commercial Lending. Due to the change in remuneration model, the MFAA advocates that these products be excluded from the Scope.

Ownership structures
The MFAA is aware of the following ownership structures within our membership.

- AFG (publicly listed)
- Aussie (80% owned by CBA)
- Choice/FAST/PLAN (wholly owned by NAB)
- Connective (18% owned by Macquarie Bank)
- Mortgage Choice (publicly listed entity)
- VOW/YBR (17% owned by Macquarie Bank)

The MFAA supports the need for transparency when dealing with consumers and therefore supports the adoption of disclosure with regards to vertical ownership structures, where they exist.

Scoping Considerations- Remuneration Structures
ASIC has identified all known remuneration structures in their Scope and it is noted that ASIC are interested in correlating all remuneration structures with the services provided by participants within the value chain.

MFAA members are keen to ensure that parity exists with all remuneration structures and/or controls for all participants, regardless of channel. Parity will ensure clearer outcomes for all consumers (regardless of channel) as well as ensuring a uniform market in which all participants can operate and flourish.

When reviewing remuneration structures, the MFAA would like to directly address a matter raised by consumer advocate groups during the round-table engagements, which contends that brokers would intentionally inflate their customers total loan value in order to maximize their upfront commission. To indulge this view, it has to be accepted that the broker is acting with intent and that their fraudulent behavior is being motivated by the perceived rewards.

Firstly, any broker who provides a loan that is 'unsuitable' is directly in breach of their obligations under National Consumer Credit Protection (NCCP) as well as the MFAA Code of Conduct. A broker spends approximately 12-16hrs (client inquiry, lodgment, settlement) on each settled file and if the average loan size of $300,000 (ABS) is used, a broker will earn (prior to costs) $1,950 in upfront commissions. If the loan size was increased by as much as 25% to $375,000, the broker would receive an additional $488.

An unsuitable loan (in this case a loan which is larger in value than a customer can afford) will directly put at risk a brokers ACL/CR license and therefore the viability of their overall broker business and ongoing income. The behavior also exposes the broker to claw-back, or at the very least, a loss of trail due to the loan entering arrears or defaulting. The MFAA challenges that any participant that gives credence to this notion is ill-advised on the barriers to becoming a broker, the costs for compliance and licensing as well as awareness of the longer term value that can be created through the successful development of a broker business.

Payments
The MFAA supports all the remuneration categories identified by ASIC in their Scope.

To ensure broader industry success and ongoing benefits to consumers, the MFAA advocates that all monetary rewards be fully disclosed and that access to non-monetary rewards is clear and measurable, and that a willingness to participate does not create a bias towards any one industry participant over another.

MFAA members are mostly small to medium entities (SME's) and are therefore heavily reliant on business cash-flow to continue to develop their businesses. The MFAA would like industry participants to give consideration to the current timing of payments within the value chain and look for opportunities to make earlier payments where possible.

The MFAA requests that when conducting its review, ASIC objectively looks at the flawed assumptions that drives the incorrect assertion that mortgage brokers deliberately inflate loan amounts in order to maximize their commissions.

Scoping Considerations- Consumer Outcomes

The MFAA supports the consumer categories identified by ASIC within the Scope. The MFAA further notes that its members s currently offer and support customers with these requirements. The goal, and challenge for ASIC's Review rests with defining a good customer outcome and then accurately measuring industry performance.

The MFAA recommends that brokers assess their customers' satisfaction with the performance of their settled loan on three (3) key areas including; loan product (features), lender (process) and broker (performance). The MFAA encourages its members to conduct customer reviews 45 days following settlement, which ensures that customers have had adequate time to complete their first mortgage repayment. Due to the range of industry participants, customer satisfaction is not measured or captured in a uniform manner.

Conclusion

The MFAA supports/does not support the contents of the Review of the Mortgage Broker Remuneration Structures Scoping Discussion Paper.

MFAA will highlight key points and leave open for further discussion with ASIC if necessary.