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Dear Sir/Madam

MFAA Response to the ASIC review of mortgage broker remuneration, 16 March 2017

On behalf of the Mortgage & Finance Association of Australia (MFAA), we welcome the opportunity to respond to the Australian Securities and Investments Commission (ASIC) review of mortgage broker remuneration, and specifically to the Review paper released by ASIC on 16 March 2017.

The MFAA also welcomes the contribution the ASIC review of mortgage broker remuneration is making in enhancing consumer outcomes and ensuring that remuneration structures throughout the mortgage and finance value chain continue to support strong competition in the wider mortgage finance sector.

This submission seeks not only to address the key recommendations of the ASIC Review, but also to outline the MFAA's approach to the task of industry self-regulation, and to provide an update on the steps which have already been taken with that objective in mind.

The MFAA strongly supports industry self-regulation, and believes that this is the best way to achieve genuine change throughout the mortgage and finance value chain, and to enhance consumer outcomes. The MFAA does not believe that this means retention of the status quo, and as such has addressed each of the ASIC recommendations in some detail. This response is forward looking, and discusses options for genuine industry change. The MFAA does not seek to re-prosecute the ASIC Report, and welcomes the comments made by ASIC, both in its Report and through public comment that affirmed the strong contribution that mortgage and finance brokers make in enhancing industry competition, and driving positive consumer outcomes.

A summary table of the MFAA's consideration of initiatives in response to each of the key ASIC recommendations is contained in **Annexure 1**.

In forming this response, the MFAA has undertaken extensive member consultations. These consultations have covered the entire mortgage and finance value chain, from lender to aggregator to broker. The MFAA has also collaborated with the Australian Bankers' Association (ABA) to take a joint leading role in the establishment of an industry-wide working group (Combined Industry Forum) which encompasses the Australian Bankers' Association (ABA); the Mortgage & Finance Association of Australia (MFAA); the Finance Brokers Association of Australia Limited (FBAA); the Customer Owned Banking Association (COBA); as well as industry representatives from lending, aggregation and broking businesses. This forum was initially convened on 9 June, at which time its key guiding principles were established, and the views of all participants were heard. This is an extremely important forum, as it is a medium through which the industry can find alignment and make the necessary self-regulatory changes required to improve consumer outcomes (Joint media release **Annexure 2**).

1. Background to the MFAA

With over 13,000 members, the MFAA is Australia's leading professional association for mortgage and finance brokers. The stated purpose of the MFAA is to advance the interests of our members through leadership in advocacy, education and promotion. To achieve this aim, the MFAA promotes and advances the broker proposition to consumers as well as to external stakeholders including governments and regulators, and continues to demonstrate the commitment of MFAA professionals to the maintenance of the highest standards of education and development to drive appropriate consumer outcomes.

It is estimated that around 17,000 mortgage and finance brokers operate in Australia.[1] In March 2017, *Comparator Business Benchmarking* found that local brokers' market share then stood at 53.6 per cent for home loans written compared with 70 per cent for the UK (in 2016)[2], 27 per cent for Canada, less than 40 per cent in the US and 25 per cent in New Zealand. Industry participants[3] agreed that within five years, mortgage brokers will account for 60 per cent of home loans in Australia based on prevailing growth trends.

2. Key Recommendations from the ASIC Report

ASIC's Report 516, "Review of mortgage broker remuneration", made 13 key findings and six specific recommendations. The findings focused on commission structures; soft-dollar benefits; key characteristics of the broker channel; value chain ownership structures; governance and oversight; and data quality and public reporting. These findings framed ASIC's key recommendations which painted a picture of potential conflicts of interest in current remuneration practices; and assessed the relative 'health' of the mortgage and finance broking industry.

Generally, the Report endorsed the role that brokers can play in the provision of strong consumer outcomes and enhancing competition in the home loan market (paragraphs 18 to 22):

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[1] IBISWorld, *Mortgage Brokers in Australia: Market Research Report*, August 2016, p. 1, http://www.ibisworld.com.au/industry/default.aspx?indid=1821.

[2] IRESS, *Intermediary Mortgage Survey 2016*, p. 7, https://www.iress.com/files/1214/5995/3077/UK_IRESS_IMS_2016_FINAL.pdf.

[3] Ernst & Young, *Observations on the Value of Mortgage Broking*, May 2015, p. 2, https://www.mfaa.com.au/IndustryInformation/Documents/1527742_MFAA_Broker%20Study_final_email.pdf#search=observations%20on%20the%20value.

> Brokers play a very important role in the home loan market. They are responsible for arranging around half of all home loans in Australia. Consumers are increasingly turning to brokers to get help in obtaining a home loan—in 2012 brokers arranged 47.7% of home loans for the lenders in our review. In 2015, this increased to 54.3%.
>
> Brokers arranged almost 520,000 new home loans from the lenders in our review in 2015 (compared to 340,000 in 2012).
>
> Brokers can play an important role in promoting good consumer outcomes and strong competition in the home loan market.
>
> From a consumer outcomes perspective, in a well-performing market brokers can help:
>
> (a) match the needs of the consumer with the right home loan product and lender;
>
> (b) navigate the home loan application process, which can be daunting for many consumers; and
>
> (c) improve consumer understanding of home loans and financial literacy.
>
> From a competition perspective, brokers have the potential to:
>
> (a) play a valuable role in providing a distribution channel for lenders—especially smaller lenders—without their own distribution network (e.g. branches);
>
> (b) exert downward pressure on home loan pricing, by forcing lenders to compete more strongly with each other for business.[4]

However, the report raised concerns that "*remuneration and ownership structures can … inhibit the consumer and competition benefits that can be achieved by brokers.*"[5] Whilst there was no evidence that current remuneration structures are lessening competition or leading to poor consumer outcomes, the report found that conflicts of interest existed and that there is a need for change.

From these key findings, ASIC specifically developed six proposals, aimed at improving consumer outcomes and competition, for further consultation:

1. Improving the standard commission model
2. Moving away from bonus commissions and bonus payments
3. Moving away from soft dollar benefits
4. Clearer disclosure of ownership structures
5. A new public reporting regime
6. Governance and oversight

These six key proposals form the basis of this consultation process, and are as such a key focus of the MFAA's submission. In addition to these proposals, the MFAA's submission addresses the key issue of industry self-regulation; sets out the processes the MFAA has itself established, as well as those it is working on with the wider mortgage and finance industry, to commence the process of self-regulation; and provides an indicative work plan.

3. MFAA Approach to Self-Regulation

The MFAA views self-regulation as an opportunity, not a right. Any self-regulatory response needs to be fit for purpose, have consumer outcomes and competition at its heart, and genuinely tackle

[4] ASIC Report 516, *Review of mortgage broker remuneration*, p9.
[5] Ibid.

areas of conflict of interest in remuneration. The self-regulatory reforms which the MFAA develops, alongside the wider mortgage and finance industry, should be viewed as a package, rather than in isolation. This reflects the fact that many of the proposals recommended by ASIC are inter-connected, with, in many cases, solutions to one particular proposal resolving or contributing to the resolution of issues in other proposals.

In considering its specific responses to each of the ASIC proposals, the MFAA developed some key principles which should guide any reform proposals. In short these are, the mortgage and finance industry:

- supports industry self-regulation
- has better consumer outcomes at the centre of its approach
- is committed to transparency and accurate disclosure
- will promote competition at all levels of the industry
- aims not to change the structure of the industry or unfairly disadvantage any part of the value chain
- will promote simple and achievable solutions
- seeks solutions which can be applied to all States and Territories.

These principles are strongly supported both by MFAA members, and by the wider industry participants with whom the MFAA has so far consulted. Importantly, they also form the basis of the guiding principles agreed to by the wider Combined Industry Forum in which the MFAA is participating alongside other industry associations and member organisations.

As mentioned, the MFAA convened a number of member forums to assist with the formulation of this submission. These included:

- **MFAA State Broker Roundtables** – held in each capital city and selected regional locations, and comprising licensed brokers and credit representatives
- the **MFAA National Lenders Forum** – comprising senior representatives from the big four banks, international, regional and other lenders
- the **MFAA National Aggregators Forum** – comprising both bank-owned, independent and publicly listed aggregators, and covering most aggregator business models
- the **Joint MFAA Steering Group** – comprising representation from the MFAA National Lenders Forum, MFAA National Aggregators Forum, MFAA Management and advisers.

In addition, the MFAA worked with the ABA to establish a wider Combined Industry Forum to focus on the implementation of industry self-regulation. This move reflects that no part of the mortgage and finance value chain can seek to regulate itself in isolation from the others. Whilst much of the ASIC review focused on commissions and incentive payments to both mortgage and finance brokers and aggregators, these payments are not set at this level of the value chain. Most such payments are set by lenders, and are implemented contractually with brokers and aggregators. Equally, there needs to be alignment between all industry participants on proposals relating to governance and oversight, as well as on those which relate to professionalisation.

The first meeting of this joint industry working group was held on 9 June, and there was a high degree of alignment between participants on the objectives of the group and indeed the importance of the task before us. The group is now determining a specific work plan to address the ASIC proposals, and to establish the metrics and data requirements for effectively implementing change.

An important part of this initial process is to develop an efficient and achievable timeline, which enables the development of effective solutions, whilst ensuring that the momentum for change is maintained. The industry as a whole will need to take time to understand the unintended consequences and behavioural economics of any proposed changes to ensure we are not diminishing competition or causing negative structural change to the home lending market and its participants.

4. <u>MFAA Analysis of the ASIC Proposals</u>

In assessing each of the ASIC proposals, the MFAA has focused on its key guiding principles (See section 3) while looking at some of the potential solutions in both the ASIC report, as well as in the report to the ABA by Stephen Sedgwick – Retail Banking Remuneration Review (Sedgwick Review). Equally, many similar regulatory changes have been undertaken in other sectors including the financial services and advice sectors, and individual lenders over time have adopted different remuneration models. Key to our analysis has been both the suitability of the proposed options, as well as their ability to be implemented in a timely manner.

4.1 Improving the standard commission model

The ASIC Report states in paragraph 26 that:

> Brokers almost universally receive commissions paid by the 'supply side' of the market (i.e. the lender or aggregator), rather than by the consumer. Our review identified significant variability and complexity in remuneration structures between industry participants. The common element across all remuneration structures for brokers, however, was a standard commission model made up of an upfront and a trail commission.[6]

The Report also explained what ASIC saw as the key conflicts of interest which arose through this model (paragraph 29).

> This standard model of upfront and trail commissions creates conflicts of interest. There are two primary ways in which these conflicts may become evident. Firstly, a broker could recommend a loan that is larger than the consumer needs or can afford to maximise their commission payment. This may also involve recommending a particular product or strategy to maximise the amount that the consumer can borrow (e.g. through the choice of an interest-only loan). In this report, we have referred to this as a 'product strategy conflict'. Alternatively, a broker could be incentivised to recommend a loan from a particular lender because the broker will receive a higher commission, even though that loan may not be the best loan for the consumer. We refer to this as a 'lender choice conflict'.[7]

In terms of the 'product strategy' conflict, ASIC believes that brokers could be incentivised to recommend larger loans to consumers (paragraph 30).

> We found that commissions may be paid in a way that could result in product strategy conflict. In general, because commissions are linked to the size of the loan, the more that a consumer borrows, the more the broker will be paid. In practice, we found it common for remuneration structures to pay commission on the total amount of borrowing approved, rather than the amount of funds actually drawn down.[8]

[6] Ibid, p9.
[7] Ibid, p10.
[8] Ibid.

ASIC is also concerned that the standard commission model could result in a "higher level of lender choice conflict" given the "significant variability in the value of commissions paid by different lenders". Paragraph 32 goes on to explain:

> …Even when limiting our review to the commission rates paid only by ADIs, the differences in rates of upfront commission paid to individual broker businesses tended to vary between lenders by at least 0.10%, while variations of up to 0.30% were not uncommon. An increase of 0.10% commission on a $500,000 loan equates to an extra $500 paid to the broker business. These differences were also evident for trail commissions, where variations in the rates of commission tended to be between 0.05% and 0.15%.[9]

To deal with these perceived conflicts ASIC recommends in paragraph 115 that:

> 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 the loan.[10]

The Report also states in paragraph 35 that:

> We (ASIC) consider that changes could be made to the standard commission model to reduce the risk of brokers seeking to inappropriately maximise their commissions. We recommend that a further review is conducted in three to four years to determine whether further (and more fundamental) changes to the standard model are required.[11]

The MFAA agrees with ASIC that the standard commission model does need to be looked at to ensure that such conflicts are mitigated. In so doing, the MFAA appreciates that ASIC is not saying that these changes are leading to poor consumer outcomes; rather that such conflicts could lead to such outcomes. The MFAA also supports ASIC's view that the current commission structures – upfront and trail commissions – do not need to be abandoned, and that the improvements to the model should be assessed in three to four years' time.

The industry is looking at genuine changes to the model which will hopefully relieve both the 'product strategy' and 'lender choice' conflicts. That said, the MFAA believes that changes to the standard commission model are most appropriate for dealing specifically with the 'product strategy' conflict, as the 'lender choice' conflict is dealt with more appropriately in the reform options targeted in ASIC's proposals 2 and 3.

When considering the 'product strategy' conflict, the MFAA does not believe that it can be simply resolved by de-linking commissions from loan size. To do so would ignore the fact that 'economic value' increases with the size of a loan. This is an important concept for lenders, who currently price their home loan portfolios with a consideration for economic value. This concept is further explored below when the option of a 'lender-based fee for service' is analysed.

The MFAA has considered a variety of options, both from the ASIC and Sedgwick reports, as well as those developed as a result of industry consultations. These options are explained and analysed below, and are also captured in the summary table in **Annexure 1**. These options should not be seen as exhaustive, but rather as a reflection of current industry thinking. We are also not yet in a position where we can outline a package of reforms to the standard commission model, however,

[9] Ibid.
[10] Ibid, p24.
[11] Ibid, p11.

this analysis will form the basis of the work which will be undertaken by the industry to determine appropriate self-regulatory measures.

4.1.1 Upfront commissions paid on drawn amount net of offset

The ASIC report specifically targeted the issue of loans initially established with large offset balances. When discussing various options the industry could consider, ASIC stated:

> We also propose that lenders do not structure their incentives in a way that encourages the creation of larger loans that initially have large offset balances.[12]

This issue was also mirrored in the Sedgwick review Final Report:

> ASIC has also proposed that lenders improve the standard commission model so that “brokers are not incentivised purely on the size of the loan”. They suggest commissions could be affected by a range of factors, including the LVR of the loan, the loan payment type, or the credit risk of the borrower and be structured in ways that do not encourage “the creation of larger loans that initially have large offset balances”.[13]

The key issue here is that ASIC believes that the use of offset facilities often encourages consumers to take out larger loans than they actually need at the time of acquiring the facility. There also appears to be a belief that, while the offset account may initially increase the affordability of the loan, this could significantly change should the money in the offset account be drawn down.

The use and availability of offset accounts in the Australian home loan market has been both a popular and positive development for consumers. Such accounts are not widely available in overseas home loan markets, and enable customers to ‘offset’ the interest they are paying on their home loans against the savings (or increased loan amount) they have in the offset account, whilst keeping these savings liquid. Customers have the ability to have their income (wages and salaries) and other benefits paid into these offset accounts, which they then operate as a transaction account. Rather than receiving interest on the balance of these accounts, the balance is simply offset against the loan account, reducing the amount in the home loan account upon which the interest is calculated. This is not only a tax effective way of saving for many consumers but also in many instances contributes to a faster reduction in principal repayments due to interest savings.

The MFAA believes that these accounts greatly enhance consumer outcomes if utilised appropriately, and as such should not be inappropriately discouraged. The MFAA does, however, believe that more can be done to ensure that they are used appropriately, and that customers are informed of the total potential cost of the additional offset funds over the term of their loan. To that end the MFAA believes that:

> *Where a broker has recommended, or a customer has requested, that the loan size be increased and a portion be placed in offset, the broker should calculate the additional loan repayments over the term of the loan, including the additional offset loan amount, and present these figures against the sum of loan repayments excluding the additional offset loan amount, with the net balance being disclosed to the customer as the maximum possible additional cost (principal and interest) of repaying the offset funds over the life of the loan in the event the offset funds are used.*

While such an affordability analysis of the loan would be undertaken by the mortgage broker regardless, it is important that this additional analysis specifically targets the additional cost of the

[12] Ibid, p24.
[13] Stephen Sedgwick, *Retail Banking Remuneration Review,* Final Report, p37.

funds in offset on the assumption the offset funds are used, and should be disclosed to the customer at the time the option is being considered. Such a measure would ensure that the customer fully understands the potential future cost of their decision, and not just the 'day one' affordability of the loan, or the financial flexibility of having the additional funds in the offset account.

The MFAA also believes that changes need to be made to ensure that brokers are not unduly incentivised to recommend the use of offset balances by customers. The MFAA does not, however, believe that a broker should be penalised for recommending a facility with an offset balance when this is appropriate to the customers' imminent funding needs. This reflects the fact that for many customers there are sound benefits from using offset account facilities. These benefits include the financial flexibility of easily accessible additional loan funds in an offset account for a financially literate and responsible customer.

The simplest way to remove any incentive for recommending the inappropriate use of offset balances would be to pay up front commissions on the drawn amount of the loan, net of offset. This would mean that the broker would not receive commission on the amount of the loan paid into the offset account, thus removing any incentive for them to promote its use. By way of a simple example, if customer X wishes to buy a house and requires a loan of $600,000 to do so, with say an LVR of 60%, but then wishes to borrow an additional $150,000 (held in offset) for future renovations; the broker's commission would be calculated on the $600,000 (not the $750,000 which would currently be the case).

The MFAA believes that this is a fair proposition, as long as the funds held in offset are not drawn down within a reasonable period. If they are drawn down within say 6 to 12 months then the broker should reasonably expect to be remunerated on the total drawn down amount. To do otherwise would simply result in a reduction in broker income as a ratio to utilised funds.

To fix this problem and based on the capacity for lender implementation, the MFAA believes that the following option should be considered:

- Commission paid on drawn amount less offset balance.
- Review the offset balance in 6 to 12 months (to be decided) and pay a 'top up' of upfront commission:
    - based on the offset balance at the time of review
    - only if the offset balance is less than a materiality threshold (say 90%) of what it was immediately after the loan was drawn.
- If the offset balance is greater than 90% of what it was at the time the loan was drawn then no top-up is payable. This 10% buffer is to put in a materiality test and to remove any normal fluctuations that one would expect to occur in an offset balance.

Using the example above, the broker's commission would initially be calculated on the $600,000 drawn amount. At the time of the 'top up' review (6 or 12 months) if the customer has drawn down $100,000 from their offset account, leaving a balance $50,000 (67% drawn), then the broker will receive a 'top up' commission on this $100,000. If however the balance in the offset account remained at between $135,000 - 150,000, the broker would receive no additional commission (other than the normal trailing commission).

This solution is superior to the drawn amount less offset balance approach, as it remunerates the broker on total drawn funds (and reflects total economic value) over time, whilst removing the financial incentive to recommend loans with initially large, unutilised offset balances (as recommended by ASIC) where there is no imminent intended use in mind.

Other variations on this model were also considered, however each had potential problems which reduced their desirability. First, we assessed whether claw-back arrangements should be used if the funds in the offset account were not utilised over time. The main problem with this was the fact that the broker would receive the total commission up-front, leaving much of the perceived 'product strategy' conflict in place. The second model was to only pay commission on the offset funds which were used for 'legitimate investment purposes'. The MFAA had problems with this option on two levels. First, it was not up to the mortgage and finance industry to dictate to the customer on what 'legitimate investment purposes' were. Secondly, this would always be an entirely subjective assessment, making it entirely contestable by brokers, and needlessly increasing pressure on compliance.

The MFAA believes that its proposal for commissions to be paid on drawn amount less offset (with an upfront top up) is achievable, directly tackles 'product strategy' conflict, and is something which could be implemented relatively quickly by the industry.

4.1.2 Upfront commissions with LVR pivot

Both the ASIC and Sedgwick reports suggested that the industry consider a commission mechanism by which brokers could be disincentivised to recommend loans with high Loan to Value Ratios (LVR). This has been driven to some degree by ASICs finding that (paragraph 51):

> Even after controlling for differences, compared to consumers going directly to lenders, we found that consumers going through broker channels obtained:
>
> (a) loans with higher LVRs (typically between 1 and 4%, depending on the lender); and
>
> (b) larger loans in dollar terms.[14]

And in paragraph 837:

> Compared with those who borrowed through direct channels, consumers who used brokers tended to have greater leverage (indicated by a higher LVR). This is consistent with our previous observations that those who borrow through brokers tend to have a combination of larger loans and lower property values.[15]

However, in paragraph 842, the ASIC Report downplayed any potential link between broker upfront commissions and higher LVR loans.

> There was some evidence of a relationship between the amount of broker commission and LVR. Generally, a higher rate of trail commission appeared to correspond with a higher LVR. There did not appear to be a relationship between upfront commissions and the value of LVR.[16]

The MFAA's anecdotal evidence is that customers with more complex, or more difficult loan scenarios, tend to gravitate towards the broker channel when their needs have not been met by lenders directly. We believe this goes some way to explaining the disparity on higher LVRs and loan size between broker-introduced and direct lending.

We have nevertheless considered a number of options to disincentivise high LVR loans via potential changes to upfront commission structure.

The first option which was considered was to pay a lower percentage of commission for higher LVR loans and higher percentages of commission for lower LVR loans. For this to work it would need to

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[14] ASIC, op cit, p14.
[15] Ibid, p158.
[16] Ibid, p160.

be structured around an agreed pivot point e.g. 80% LVR. By way of example only, the following may be an adjusted commission table for LVR:

95% LVR	=	0.0053	
90% LVR	=	0.0057	
85% LVR	=	0.0061	
80% LVR	=	**0.0065**	**Pivot**
75% LVR	=	0.0069	
70% LVR	=	0.0073	
65% LVR	=	0.0077	

Such a commission model would still include loan size, and therefore reflect economic value, but would then provide a direct disincentive to brokers writing high LVR loans. We could have assumed that this would in turn lead to lower general loan sizes, however, the case that current remuneration structures are actually negatively impacting consumer outcomes in this regard has not been made. This model would also align to wider prudential objectives and reflect the references to LVR made in both the ASIC and Sedgwick reports. It correlates to the principles of risk weighted capital, and if implemented correctly would not necessarily lead to a reduction in total broker income (assuming lower LVR loans were sufficiently well incentivised). It would also be easy for the industry to explain, with LVR being a well-established concept, and might be implemented with relative ease.

The problem with this model is that higher LVR loans do not always lead to poor consumer outcomes, and in many cases are the route by which many young Australians achieve homeownership.

The MFAA is not recommending its adoption at this time due to the many unintended consequences it appears to carry with it. From a broker's perspective, the biggest problem is that, to a large degree, this model would result in a remuneration structure that has an inverse relationship to broker effort. For example, higher LVR loans tend to require more documentation, a greater degree of lender interaction, and in many cases the utilisation of Lenders' Mortgage Insurance (LMI). This is certainly the case for many first-time buyers, as it is for a significant number of professionals, where high LVR loans align with their complex financial and trust structures, significantly adding to the workload of their broker.

Such a model would also ignore the valid use of tax-driven high LVR loans in investment property lending - and often where the customer is in fact advised by their accountant or financial planner not their broker. It would also unfairly discriminate against brokers based in certain regional and lower socio-economic areas where high LVR loans can be the majority of a broker's business.

Most concerning, however, is that a model which disincentivises brokers from recommending high LVR loans could steer them away from first time buyers. This could lead to a reduction in competition for loans in this sector by increasing their reliance on bank branch-based lending. It could also increase the pressure on vulnerable family members (such as aged parents) of first time buyers, who are pressured by the buyer to provide guarantees or direct capital investment to help lower the LVR.

The only way that this could be avoided would be to provide carve-outs for first time buyers and for investment lending (which is partially tax driven). Whilst this may appear to be a simple enough solution, it would significantly reduce the effectiveness of the model by removing a large number of the high LVR loans from its scope. If this were to be done, it would reduce the population coverage to such a degree that it would be ineffective as a policy measure, and simply add a degree of unnecessary complexity into the commission model.

In considering an LVR measure as a potential solution, we also need to be mindful that there have already been a number of prudential measures focussed on this area particularly around interest-only loans and serviceability which are yet to fully filter through and which will naturally bring down LVRs.

4.1.3 Standardising upfront commission

In order to deal with what ASIC calls the 'lender choice' conflict through changes to the commission model, some degree of standardisation would need to be considered. Whether this would mean all lenders paying the same flat commission percentage, or the adoption of an acceptable range, or even the implementation of commission caps, it would have serious implications for competition in the home lending market.

This concern is indirectly endorsed by both ASIC and Sedgwick in their reports, where they both refer to the best implementation methods for changes to broker remuneration to be through individual contractual negotiations. The establishment of such a flat percentage model would significantly reduce the effectiveness of these negotiations, and remove incentive at all levels of the mortgage and finance value chain to innovate for better consumer outcomes thereby in our opinion making it non-viable.

4.1.4 Reduce upfront commissions and increase trail commissions

This proposal would see the balance between upfront and trail commissions shift to be in favour of a higher trail. The ASIC report notes that broker businesses receive on average an upfront commission of 0.54% and a trail commission of 0.14%. The main reason for considering this proposal is that a focus on trail, rather than upfront commission, could increase consumer confidence as more of the funds a broker receives are for service over the life of the loan. ASIC also states in paragraph 432 that:

> The payment of ongoing trail commissions usually provides an incentive to aggregators and brokers to put forward higher quality loans where consumers are less likely to default on their obligations[17]

The MFAA would agree with ASIC in this regard, however we believe that a move to shift income from upfront to trail as is being considered in this point 4.1.4 would miss the mark as although it may reduce the 'product strategy' risk by increasing loan quality, it would not in any way reduce the potential for 'lender choice' conflicts. It would also disadvantage new entrants in the broker market, as it takes a considerable period of time for a broker's trail book to become established. Reducing up-front in favour of trail would extend the break-even point for new brokers and increase the amount of capital required to successfully establish a broking business, thereby discouraging new entrants and further reducing market competition.

4.1.5 Lender based flat fee for service

Under this model, a lender would pay a flat fee to brokers (for example via their aggregator), regardless of loan size or any other quality metrics. This would remove the 'product strategy' conflict associated with loan size and would be relatively easy to administer, however, it suffers from a number of shortcomings.

[17] Ibid, p84.

The MFAA does not support this proposal as we believe it is important that brokers are rewarded based on the economic value of the loans they originate and this alternative would break the nexus between broker remuneration and economic value removing the alignment of objectives between lender and broker that economic value creates. As this model does not link lender costs to revenue, it would require a lender to use high value loans to cross-subsidise low value loans, and could result in them pushing up the Annual Percentage Rate (APR) on lower value loans to compensate. It would further inevitably result in one broker cross-subsidising another.

A tiered flat fee as an alternative would suffer from many of the same shortcomings but with a heightened conflict of interest as a customer's intended borrowing approaches a tier threshold, once again making it unsuitable.

See 1.13 in Annexure 1 for further unintended consequences.

4.1.6 Broker quality

The ASIC report emphasises the opinion that a move away from volume-based payments, or commissions based solely on loan size, in favour of quality based measures would significantly reduce conflict of interest. It describes "non-volume based incentives" as "a payment that is dependent on something other than the value of home loans sold".[18] Whilst this definition is more directly relevant to ASIC proposals 2 and 3, there may also be an opportunity in time to partially link commission structures to non-volume or quality metrics.

Paragraph 492 states that:

> Based on our review of term sheets, there are a wide variety of such payments, including those that are dependent on:
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> (a) the rate of conversion of home loan applications into settled loans;
> (b) the rate of approval of home loan applications;
> (c) the proportion of applications that are submitted online;
> (d) the quality of loan applications submitted by a broker (i.e. complete and without errors); and
> (e) the average LVR across home loans settled.[19]

The main problem with these metrics is that they are mainly trailing indicators, and as such are hard to immediately apply to an individual loan. The MFAA strongly supports the use of a broker quality measure as a potential multiplier for commissions, but cautions that a significant amount of work needs to be done to make such measures entirely objective and not contestable. Ideally, the definition of quality should also be standardised across the industry. Much of this work will be done in responding to ASIC proposal 6 – Governance and oversight, and will as such be further addressed later in this submission.

4.1.7 Removal of broker accreditation by lenders

This is an issue which was raised with the MFAA by ASIC after the Report was published. ASIC questioned whether the threat of accreditation termination could make a broker's 'lender choice' conflict more acute. This issue relates to a lender removing a broker's accreditation for not selling enough of their loans. The incentive would then be for the broker to immediately recommend more of that lender's home loans to maintain their accreditation which may not be an optimal consumer outcome.

[18] Ibid, p92.
[19] Ibid.

The MFAA believes that lenders should have the right to remove accreditation from brokers but that this is an area that requires further discussion. In many cases, lenders are concerned that brokers who have not written their home loans for some time do not have sufficient up to date knowledge of product and process to do so. Anecdotally, such brokers, who had not been active for many years, submit home loan requests sometimes using superseded forms or inefficient communication channels. Equally, such brokers would not be current in regards to the lender's risk appetite or compliance standards, which could lead to substandard consumer outcomes.

The MFAA agrees that the threat of removal of the lender accreditation of a broker could increase 'lender choice' conflict. The MFAA believes that the process for the removal of lender accreditation of a broker should be reviewed to ensure that it does not increase 'lender choice' conflict. The removal of the "hard edge" of accreditation loss could be achieved by placing another step in the process. Such a step could be that the broker needs to complete additional training or re-education within a certain period and that their accreditation can only be removed if that does not occur. The MFAA also believes that a lender should be able to terminate a broker's accreditation for conduct, quality and/or educational purposes, but equally needs to resolve how such a broker's existing clients will be serviced.

4.2 Moving away from bonus commissions and bonus payments

The ASIC report states in paragraphs 119 to 121 that:

> 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.
>
> Bonus commissions have raised concerns in other parts of the financial services industry. The prohibition on volume-based commissions introduced by the Future of Financial Advice (FOFA) reforms is now being extended to life insurance as part of the Government's reforms to life insurance commissions.
>
> We consider that the risks posed by bonus commissions (e.g. volume-based commissions) in other parts of the financial services industry also apply in the home loan market. Accordingly, we propose that the industry moves away from bonus commissions and bonus payments.[20]

The MFAA agrees that commissions based purely on volume should be phased out, and replaced by payments based on a 'balanced scorecard' including broader quality metrics.

The MFAA proposes the immediate removal of volume-based payments made from lenders directly to brokers. As these payments relate to the specific number or value of home loans sold by a broker from an individual lender they directly impact 'lender choice' conflict.

The MFAA also supports the phased-out removal of payments to aggregators based purely on volume, and their replacement with payments based on a balanced scorecard including quality metrics. Whilst it is our understanding that many lenders are in the process of replacing these payments, the MFAA supports a reasonable timeframe being established for their replacement. Whilst this process is underway, the MFAA recommends an immediate moving away from volume-based payments from lenders to aggregators being passed directly on to brokers. This would stop the perception that aggregators are being used as a post box for lender VBIs to brokers.

[20] Ibid, p24-25.

The ASIC report provides us with much commentary on the types of non-volume based payments which could be used. Paragraph 493 states that:

> Some examples of non-volume based bonuses include:
>
> (a) a settlement conversion bonus that was paid if the percentage of applications to settled home loans exceeded 60%, where the rate of bonus depended on the percentage of applications settled and the overall value of loans originated in that year (with the maximum bonus equal to 0.15% of the total loan volume in that year); and
>
> (b) an online application bonus that paid a bonus of up to 0.05% of the loan volume if at least 95% of applications were submitted online.[21]

Other examples were previously cited on pages 10 and 11 of this submission. Importantly, much work still needs to be done on the appropriateness of the proposed non-volume based measures to ensure that the valuable revenue stream from lender to aggregator is protected. Such payments are made to aggregators by lenders in recognition of the investment that larger aggregators, in particular, have made in developing platforms which have enhanced distribution of lenders' products and ensuring that brokers have an opportunity to receive subsidised ongoing compliance training, professional development and information about emerging business trends.

Another area of volume-based activity which was identified as a concern by ASIC were campaign-based commissions. Paragraphs 774 and 775 state that:

> We found that campaign-based bonus commissions do work: for one lender offering higher commission for a limited period, the volume of home loans sold increased by a factor of over four.
>
> Apart from campaign-based bonus commissions, we found that paying a higher upfront commission may assist larger lenders to get more loans (this may not work as well for smaller lenders).[22]

The MFAA supports a ban on campaigns from lenders based on higher rates of commissions to either aggregators or brokers. However, such campaigns need to be distinguished from those which are based on consumer beneficial attributes such as interest rate reductions – with the latter to be retained.

4.3 Moving away from soft dollar benefits

The payment of non-monetary rewards to high performing brokers is relatively common across aggregators as it is across many industry sectors. Whilst the type and level of such reward varies significantly, they are seen as an important method of rewarding high-performing brokers. The provision of such incentives helps to lift the overall performance of the broker group, and is the only way in which high performance can effectively be recognised.

The ASIC report states in paragraph 123 that:

> 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 FOFA reforms. We therefore propose that the industry moves away from giving soft dollar benefits.[23]

[21] Ibid, p92.
[22] Ibid, p143.
[23] Ibid, p25.

The MFAA supports better disclosure of soft dollar payments by lenders, better aligning the industry with the practices in the financial planning industry, and where paid by aggregators, to move away from such benefits being lender specific. In paragraph 390 to 392, ASIC describes the main soft dollar payments as follows:

> Soft dollar benefits given to brokers by lenders or aggregators include any rewards that are not cash. Receipt of the benefits can depend on the sale of all home loans (or specific types of home loans like white label loans).
>
> The two most important forms of soft dollar benefits identified in our review were:
>
> (a) broker clubs offered by some lenders and aggregators (which are a form of loyalty program); and
>
> (b) free attendance at conferences, including those held in overseas locations.
>
> Broker club membership is offered to individual brokers by lenders based on the value of loans sent to the lender, and offers benefits such as enhanced service from the lender and access to hospitality events hosted by the lender. We found that there are different tiers within broker clubs, each offering different levels of benefits.[24]

4.3.1 Broker clubs

ASIC notes that the use of lender specific broker clubs is reasonably widespread across the industry. In paragraph 615 and 616, ASIC describes broker clubs:

> Broker clubs are a form of incentive that is offered to qualifying brokers by some lenders and aggregators. Typically, entry to the broker club depends on the broker satisfying certain criteria (e.g. meeting particular sales targets).
>
> Membership of the club usually provides the broker with a range of non-monetary benefits (although, based on the responses from lenders, it appears that they may also provide direct monetary incentives to members). Some lenders operate broker clubs that involve multiple 'tiers', with benefits given to brokers based on the tier they qualify for.[25]

In terms of the non-monetary benefits which these clubs provide, they can include better access for a broker to a lender's staff; faster processing times; and access to better processes and systems. All of these benefits lead to good consumer outcomes as they are likely to assist a broker to establish a loan with a lender more efficiently. Some clubs also offer monetary benefits in terms of better commission rates for club members and/or lower rates of clawback. The MFAA believes that as these monetary benefits do not directly lead to good consumer outcomes they should be phased out.

ASIC is concerned about the way membership of broker clubs is attained, particularly when it is solely sales-based (paragraph 617 and 618):

> The impact on consumer outcomes of a lender or aggregator offering a broker club is likely to depend on both the criteria for accessing the club and also the benefits that are given by being in the club.
>
> If the criteria for accessing the club are sales based, there is a risk that a broker may send loans to the provider of the club to obtain the benefits of the club (even though the home loan recommended may not be the best choice for the consumer). However, even if the criteria for entry are entirely non-

[24] Ibid, p78.
[25] Ibid, p113.

> volume based, broker clubs may still increase the risk of poor consumer outcomes depending on the nature of the benefits offered under the club.[26]

The MFAA agrees that if membership of broker clubs is determined entirely on sales volume it could lead to greater broker conflict of interest (both product strategy and lender choice). This conflict of interest could incentivise brokers to write more of a lender's products to either attain club membership or retain it.

ASIC also believes that the non-financial benefits offered by clubs, whilst often leading to better consumer outcomes, could also lead to broker conflict of interest (paragraph 619):

> … if the benefits include better and quicker service levels from the lender (e.g. through dedicated loan assessment teams within the lender), there is a risk that the broker may recommend that lender's home loan without considering whether the home loan is the best choice for the consumer. A benefit such as better service levels may result in additional monetary benefits to brokers in the club as they can process more home loans in a given period due to the better lender service levels.[27]

ASIC equally is not against broker clubs per se (paragraph 620), and the MFAA response takes this into account:

> This does not mean that we consider that all broker clubs are likely to result in poor consumer outcomes. We understand that many lenders may have introduced broker clubs to recognise good work being done by certain brokers, and that the benefits granted under the club (e.g. through improved service levels) have the potential to result in better outcomes for consumers going through those brokers.[28]

The MFAA strongly supports the retention of lender broker clubs, as they are likely to lead to better consumer outcomes. That said, eligibility should not be solely assessed on sales volumes, and a balanced scorecard approach to eligibility should be adopted. Entry should potentially be based on invitation, and a balanced scorecard, with a percentage based on volume (for example, 30%) and the balance based on other quality metrics.

The MFAA also believes that criteria for a lender removing a broker from a club should not be based on volume, but rather on issues such as poor conduct, poor quality or not completing required education. The adoption of these proposed changes to club eligibility will ensure that the benefits to club membership in terms of consumer outcomes remain, whilst the potential for conflict of interest is greatly reduced.

4.3.2 Other soft dollar incentives including free attendance at conferences

The payment of non-monetary rewards to high-performing brokers by aggregators is common practice, but the MFAA believes that such rewards should not be linked to the sale of an individual product, or the suite of products offered by a particular lender but rather for performance across the aggregator's entire panel of lenders and products in order to remove 'lender choice' conflict. They should also be based on a balanced scorecard rather than purely based on volume.

The MFAA believes that the maintenance of high levels of education through ongoing training is key to maintaining a professional industry and ensuring strong consumer outcomes. An important part of this training is offered by aggregators in the form of state and national conferences. Most of

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[26] Ibid, p114.
[27] Ibid.
[28] Ibid.

these conferences are generally open to all of an aggregator's accredited brokers, and some are offered to selected brokers to reward achievement.

The mortgage and finance industry is mindful of public opinion and has already moved to better align these soft dollar reward structures to the success levels they are designed to recognise. The MFAA does not support their abolition, but believes that further disclosure and reporting standards should be adopted where appropriate and that such rewards should be based on a balanced scorecard.

The ASIC Report states in paragraph 43 that:

> As with bonus commissions, we consider that the provision of soft dollar benefits is likely to be a significant motivator for brokers to send loans to a lender to qualify for those benefits even where the choice of lender may not be in the consumer's interest (i.e. lender choice conflict). This may include placing consumers in larger loans (i.e. product strategy conflict) and lead to poor consumer outcomes described in this report.[29]

The MFAA agrees that there is merit in this statement and recommends that soft dollar benefits be delinked from the volume attributed to a given lender. In the mortgage broking industry there are two general types of soft dollar benefits: Lender specific – those provided directly to brokers by lenders; and aggregator provided benefits.

The MFAA believes that lender specific soft dollar benefits provided to brokers (other than broker clubs covered earlier) should not be linked to volume and where a soft dollar benefit from a lender in excess of a certain monetary amount (a suggested amount of $350 is proposed) is made, such benefit should be recorded by the broker in a register held by their aggregator. In addition, once an amount has been recorded in the register for a lender then the broker must disclose to a customer, at the time of recommending that lender, the cumulative total of such benefits in the preceding 12 months from the lender in question.

The MFAA believes that this solution goes some way to aligning the mortgage and finance broking industry with the soft dollar practices in the financial planning industry. In addition, where soft dollar benefits are provided to 'select' brokers as a recognition of performance, such eligibility for soft dollar benefits over $350 should be based on a balanced scorecard, where volume only forms a portion (for example, 30%) and other quality metrics should make up the balance.

As mentioned, aggregators also provide lender-sponsored training events to their accredited brokers. Such aggregator event sponsorship should be offered to a broad range of lenders (ideally all lenders on panel) and not be lender specific. Training and education events should also seek the broadest broker coverage possible. Where an aggregator is selectively inviting a sub-set of brokers to, for example, a 'Leaders Forum' or similar, selection should be based on a balanced scorecard where volume only forms a portion (for example, 30%) and other metrics should make up the balance. As we propose that aggregator soft dollar benefits will be based solely on activity across the panel of lenders, no inclusion in the register or disclosure to consumer should be necessary.

4.4 Clearer disclosure of ownership structures

The ASIC report found that competition in the home loan market is affected by ownership relationships between lenders and aggregators and the inability of smaller lenders to access or

[29] Ibid, p13.

remunerate brokers in the same way that larger lenders do. ASIC went on to state in paragraphs 75 and 76 that:

> Ownership by lenders of aggregator businesses is a form of vertical integration, where the manufacturer of the product (the home loan) also owns the distribution network for the product (aggregators). Given the role that aggregators play between lenders and brokers, the ownership of the aggregator will have an impact on brokers.
>
> In reviewing the impact of ownership structures, we considered all loans funded by a particular lender—that is, loans that carry the lender's brand, as well as loans that may be branded by the aggregator but funded by the lender (known as 'white label' loans).[30]

The ASIC report also stated that (paragraph 778):

> Three lenders with ownership stakes in aggregators generally received a proportionate number of loans sold under their own brand from their owned aggregator. For some of those lenders, when taking into account the value of white label loans funded by the lender, they received a significantly higher proportion of the aggregator's loans (compared to the lender's overall market share).[31]

To remedy the potential impacts on competition which vertical integration in the mortgage and finance value chain may have, ASIC recommends that:

> … participants in the industry more clearly disclose their ownership structures. This proposal is consistent with the findings and recommendation of the Financial System Inquiry to:
>
> > Rename 'general advice' and require advisers and mortgage brokers to disclose ownership structures.
> >
> > (Recommendation 40) (Financial System Inquiry final report, p. 271).
>
> We consider that clearer disclosure of ownership structures should extend beyond mortgage brokers and apply to all players in the home loan distribution chain, including lenders, aggregators, and brokers.
>
> Clearer disclosure should occur in marketing material and at all distribution points (e.g. websites and physical premises).[32]

The MFAA fully supports better disclosure of ownership structures, and believes that this disclosure needs to target both ownership and influence. We believe that when a lender owns a small percentage of a publicly listed aggregator, but has no influence over the activities of that aggregator, such ownership disclosure could be both misleading to the customer and damaging to the aggregator. The MFAA proposes that ownership of 20 percent and less, and which does not carry board positions, should not need to be disclosed by publicly listed aggregators.

The MFAA believes that the ownership disclosure requirements should be extended to include 'white label' products. In paragraph 309, ASIC describes white label loans as:

> … loans that are issued under the brand name of another business. In the mortgage broking market, the brand name is usually that of the aggregator and, typically, the particular white label loan will be sold exclusively through that aggregator's broker network. The white label loan will not be available through other aggregators or through direct channels.[33]

[30] Ibid, p17.
[31] Ibid, p144.
[32] Ibid, p25.
[33] Ibid, p63.

Whilst anecdotal evidence points to the fact that current disclosure levels for white label products is high, the MFAA believes that this should be made mandatory.

4.5 A new public reporting regime

The MFAA believes that the ASIC report provided a snapshot of the industry, and for the first time, collated a consistent data set to assess remuneration practices. It also uncovered areas where inadequate data existed across the industry. This included important areas such as soft dollar benefits at the aggregator level, and the lack of complete and accurate information about individual brokers through whom loans are sold.

ASIC specifically recommends (paragraph 128) that:

> To improve transparency in the mortgage broking market, we propose that there be public reporting on:
>
> (a) the actual value of remuneration received by aggregators and the potential value if all criteria for remuneration are satisfied;
>
> (b) the average pricing of home loans that brokers obtain on behalf of consumers;
>
> (c) the average pricing of home loans provided by lenders according to each distribution channel; and
>
> (d) the distribution of loans by brokers between lenders to give consumers a better indication of the range of loans that brokers within the network offer.[34]

ASIC is keen to work with the industry to determine the required dataset, as well as to seek advice on what would be other good measures of consumer outcomes. The MFAA sees that this is an extremely important task, as this process will also produce reliable data sets to assist with better governance and oversight (ASIC proposal 6).

The MFAA believes that an important first step would be to develop a single broker identifier number to enable ASIC to get the complete and accurate broker picture it desires. We believe that such an identifier, when developed, should be mandatory for use on each home loan sold. Such a unique identifier of the broker that has intermediated any loan must be provided to the lender with the application and stored by the lender throughout the life of the loan and for a period of seven years after the last interaction with a customer in line with other NCCP Act requirements.

The MFAA has already considered the use of existing identifiers, such as ACL number or Authorised Credit Representative number, however, it is not clear whether these numbers cover all brokers and staff. This solution may require a different number for use with employees who currently operate directly under their employer's ACL number.

This solution may initially be a lender specific unique identifier, but in time ideally each broker should receive a single identifier across all lenders.

4.6 Improved governance and oversight

The MFAA believes that of all the proposals put forward by ASIC, improved governance and oversight is likely to do the most to improve consumer outcomes and to improve the

[34] Ibid, p25-26.

professionalism of the industry. In its narrowest form, this measure requires great oversight of mortgage brokers by both aggregators and lenders. ASIC's proposal states (paragraph 129):

> To reduce the risk that remuneration structures may result in poor consumer outcomes and inhibit competition, there is a need for all industry participants to place greater importance on fostering a consumer-centric culture and take more care in the design and monitoring of remuneration structures.[35]

ASIC has two key components to this recommendation: the design of remuneration structures; and the oversight of brokers. In terms of the design of remuneration structures, ASIC places requirements on both lenders and aggregators (paragraphs 130 and 131):

> We expect lenders, aggregators and broker businesses to embed the principle of obtaining good consumer outcomes as a guiding factor in the design of their remuneration arrangements (both in the broker channel and in relation to their own staff).
>
> We also expect aggregators to recognise that, as the party that passes commissions from lenders to brokers, they are well placed to ensure that such remuneration is consistent with the attainment of good consumer outcomes.[36]

Key to achieving these objectives is to establish a view of what constitutes good consumer outcomes. This is not an easy task as consumer outcomes also have to relate specifically to things over which the broker, aggregator or lender has control.

The Sedgwick Review makes the following comments on the difficulty in defining customer outcomes:

> It is perhaps surprising that there is no commonly accepted definition in Australia of a poor customer outcome. In the UK context the FSA uses the term mis-selling as a proxy for poor customer outcomes. Mis-selling is defined by the FSA as a "failure to deliver fair outcomes for consumers". They go on to list fair outcomes as including:
>
> - Customers are treated fairly;
> - Customers understand the key features of the product or service and whether or not they are being given advice or information;
> - Customers are given information that is clear, fair and not misleading – information that enables them to make an informed decision before purchasing a product or service or before trading; and
> - Customers buying on an advised basis are recommended suitable products.[37]

The second component of this recommendation goes directly to the oversight of brokers by both lenders and aggregators. The ASIC Report specifically proposes that (paragraph 132-134):

> Lenders and aggregators should improve their oversight of brokers and broker businesses.
>
> We expect lenders to:
>
> (a) require aggregators, through their relevant commercial agreements, to actively monitor the consumer outcomes being obtained by brokers and broker businesses;
>
> (b) provide consistent reporting to aggregators to allow adequate oversight of brokers and broker businesses; and

[35] Ibid, p26.
[36] Ibid.
[37] Sedgwick, p30-31, citing, FSA, *Final Guidance: Risks to customers from financial incentives*, January 2013, p 9.

(c) use a consistent process to identify each broker and broker business (e.g. use of the Australian credit licensee or credit representative number where relevant, or a unique number provided by the aggregator).

We expect aggregators to:

(a) require lenders, through their relevant commercial agreements, to provide consistent reporting to the aggregator on the outcomes obtained by individual brokers and broker businesses, including those relating to loan pricing, features, clawbacks, and refinancing and default rates;

(b) actively monitor the consumer outcomes being obtained at a broker and broker business level, including those relating to loan pricing, features, clawbacks, refinancing and default rates, and distribution of loans among lenders; and

(c) retain this information in a way that can be provided to ASIC to allow us to review outcomes across the mortgage broking market.[38]

The MFAA fully supports this approach, and as a first step recommends that the industry work with ASIC to collectively define what good consumer outcomes are in this context, and how they can best be measured.

The MFAA also believes that this proposal provides the industry with an opportunity to better monitor its participants and improve professionalism. To achieve this, we recommend that we consider developing a holistic, consumer-centric governance framework that is based on self-assessment, is self-correcting and ensures continual improvement of consumer outcomes and the sustainability of the mortgage industry. Such a framework (figure 1) would match remuneration structures with behaviours and consumer outcomes and would use data/risk-based monitoring and oversight to identify potential problems (both in systems and individuals), take remedial action and adjust remuneration as required.

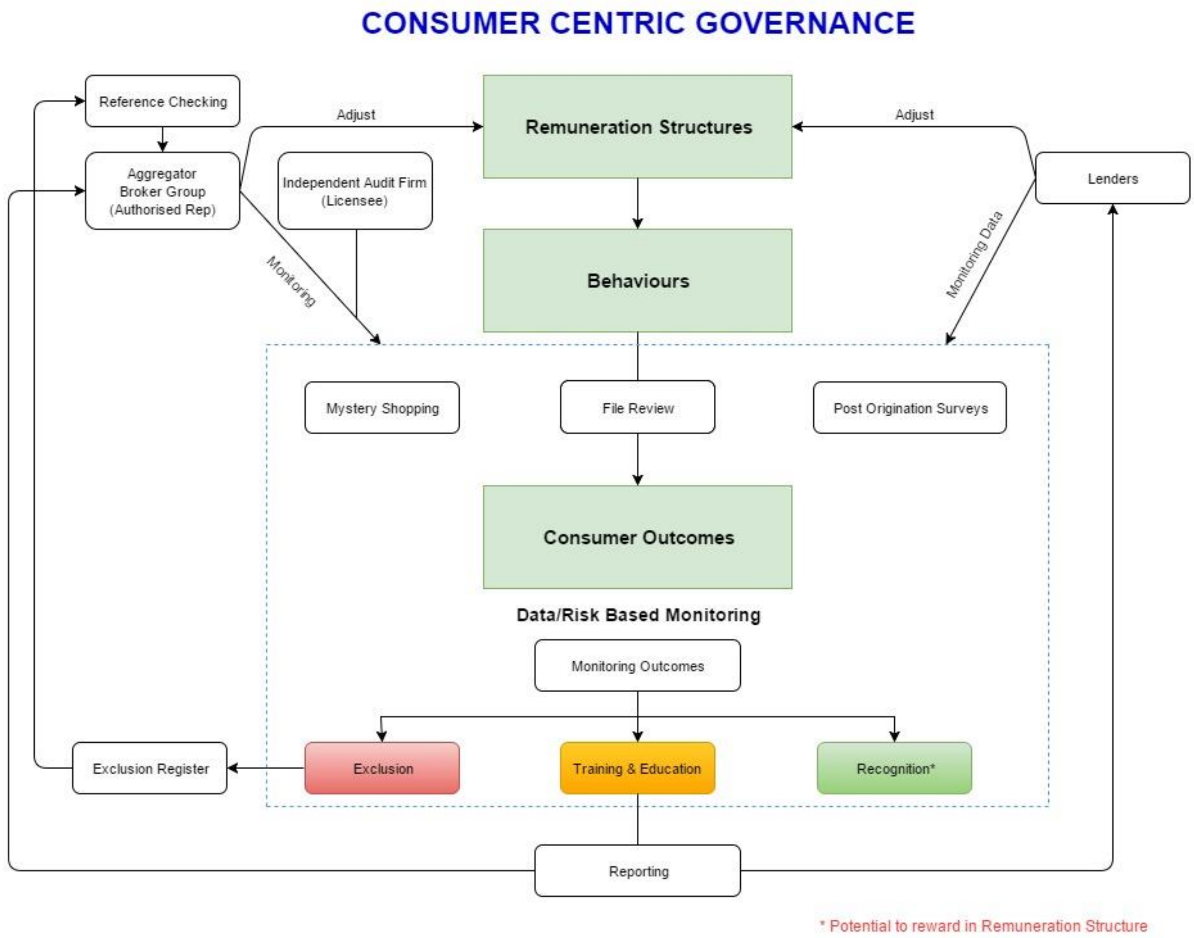
In addition to this initiative, we believe that there are other measures which the industry could undertake to increase standards of professionalism and improve consumer outcomes. First, we recommend that the industry should develop an enhanced reference checking protocol to be implemented by aggregators to assess all new brokers to the industry, or those moving between aggregators. If effective, this measure will restrict the movement of brokers that may have left an aggregator for adverse reasons. It will also need to be a fair, consistent and robust process to ensure that a broker is not unfairly restricted in their ability to move to another aggregator.

We also believe that consideration should be given to developing a mechanism whereby brokers can be effectively removed from the industry for significant poor conduct. This will require further discussion between ASIC and the industry in order to develop a potential solution, as the industry is unlikely to be able to achieve a solution in isolation. Equally, this process needs to be fair and should be achieved in a manner that does not pose risk to legitimate brokers or the organisation managing the process.

The MFAA believes that in order to truly improve consumer outcomes, lenders and aggregators will need to be responsible for the monitoring of brokers, using a risk-based approach. This approach will need to draw on both loan and performance data provided by lenders. This will require the development of an agreed performance scorecard which aggregators and lenders can use as the basis of their assessment. We believe that robust self-assessment is the mark of a mature industry, and will strengthen the industry through a cycle of continuous improvement.

[38] ASIC, p26-27.

Figure 1: Consumer Centric Governance



A key component of this self-assessment is robust, independent auditing of brokers. In most cases, this could be facilitated by the aggregator, but in the case of licensed brokers, an independent party could be used to perform the audit. Remedial action to be taken includes further education and training, reporting to relevant entities and associations, and undertaking further action to potentially exclude a broker.

To assist in this, we recommend that the industry also puts more effort into regular surveying of customers, throughout the life of their loans, rather than just immediately post acquisition. We also recommend that a program of regular 'mystery shopping' be undertaken to ensure that brokers are in fact fully compliant with all of their legal obligations and professional requirements.

The MFAA also recommends that the Combined Industry Forum established between the MFAA, ABA and other associations, remain in place to manage the self-regulation and ongoing self-assessment of the industry and to recommend further action as required. We believe that the key roles of this forum could be to:

- ensure the proposed changes are not reducing competition and reflect other current legal requirements
- evaluate consumer outcomes further
- determine the appropriate vehicles for the proposed changes (industry codes etc.)

- understand and determine all unintended consequences of the changes, and remedy them where appropriate.

5. Conclusions and summary of recommendations

As outlined in this submission, the MFAA strongly supports industry self-regulation, and believes that this is the best way to achieve genuine change throughout the mortgage and finance value chain, and to enhance consumer outcomes. Our submission demonstrates that we do not believe that the maintenance of the status quo is an option, nor do we believe that re-prosecuting the report's findings is in any way appropriate.

The MFAA's submission does, however, highlight the comments made by ASIC, both in its Report and through public comment, that affirmed the strong contribution that mortgage and finance brokers make in enhancing industry competition, and driving positive consumer outcomes.

The MFAA believes that this submission clearly demonstrates the industry's capacity for self-regulation, and delivering genuine change which is focused on enhancing consumer outcomes, and on remuneration structures that support strong competition. This submission seeks to do three things: directly address ASIC's key recommendations with real solutions; outline the industry's proactive approach to industry self-regulation; and to update Treasury on the steps we've already taken towards that objective.

While there was no evidence in ASIC'S Report that current structures decrease competition or lead to poor consumer outcomes, it did show that conflicts of interest existed. The MFAA believes that these conflicts must be addressed head-on, to ensure that we continue to drive consumer trust and confidence and the sustainability of our industry.

In forming its response, the MFAA has consulted extensively with members across the entire mortgage and finance value chain, from brokers to aggregators to lenders, and has held forums with brokers and aggregators across the country. The MFAA has also collaborated with the Australian Bankers' Association (ABA) to take a joint leading role in the establishment of an industry-wide working group that will oversee and coordinate the industry self-regulation going forward, ensuring there is strong dialogue and common purpose between all key industry participants.

The MFAA has proposed a range of potential solutions to the six proposals recommended by ASIC:

Improving the standard commission model to guard against 'product strategy' conflict and 'lender choice' conflict

The MFAA is aligned with ASIC's view that the current model should not be abandoned, but must be improved and reviewed in three to four years' time.

In response to the issues raised in the Report, the MFAA has outlined the benefits and potential unintended consequences of a range of solutions, such as standardising commissions, fee for service or reducing upfront and increasing trailing commissions. Each of these solutions creates the potential for diminished competition or negative consumer outcomes, or both.

The MFAA's recommendation is for lenders to pay upfront commissions on drawn amount net of offset (with a top-up) and to also improve disclosure by the broker when offset accounts are recommended or used. This will directly address 'product strategy conflict', in that it avoids incentivising brokers to recommend offset balances, but does not penalise a broker for recommending them when appropriate. It also ensures consumers are aware of the potential impact of using the additional funds held in the offset account.

At the same time, the MFAA recommends two additional potential measures to drive the right incentives. The first is to prevent lenders from removing accreditation of brokers based purely on volume through the introduction of an interim step requiring retraining or additional education as an alternative to immediate termination.

The second is to partially link commissions to quality measures as well as loan size once the improved governance framework is in place, which will assist the industry to incentivise the right behaviours along the value chain and form part of an important cycle of continual improvement.

Moving away from bonus commissions and bonus payments

The MFAA agrees with ASIC's view on bonus commissions based on volume and supports the phased-out removal of payments to aggregators based purely on volume, and their replacement with payments based on a balanced scorecard including quality metrics. The MFAA also proposes the immediate moving away from volume-based payments made from lenders directly to brokers, as well as from volume-based payments from lenders to aggregators being passed directly on to brokers.

Moving away from soft dollar benefits

The MFAA believes that lender specific soft dollar benefits provided to brokers (other than broker clubs) should not be linked to volume and should be the subject of greater disclosure.

The payment of non-monetary rewards to high-performing brokers by aggregators is common practice and is seen as an important method of rewarding high-performing brokers. The MFAA however, believes that such rewards should not be linked to the sale of an individual product, or the suite of products offered by a particular lender, but rather for performance across the aggregator's entire panel of lenders and products in order to remove 'lender choice' conflict. They should also be based on a balanced scorecard rather than purely based on volume.

Where an aggregator selectively invites a sub-set of brokers to, for example, a 'Leaders Forum' or similar, selection should be based on a balanced scorecard where volume only forms a portion (for example, 30%) and other metrics should make up the balance.

In addition, the MFAA supports the retention of lender broker clubs, as they are likely to lead to better consumer outcomes, but eligibility and ongoing membership should not be solely assessed on sales volumes. Rather, a 'balanced scorecard' approach should be adopted to encourage behaviour based on quality as well as sales, and to discourage poor conduct, poor quality or lack of professional development.

Clearer disclosure of ownership structures

The MFAA recommends clear disclosure of lender shareholding in aggregator or broker groups, and where a lending entity is providing 'white label' products. This will avoid the perception that lenders are exerting pressure on brokers or aggregators to recommend particular products, or 'lender choice' conflict.

A new public reporting regime

To respond to the need for greater transparency and data collection, which will assist the industry to self-regulate, the MFAA recommends a series of significant changes, including (in time) having mandatory 'unique identifiers' for brokers for each loan funded, the provision of loan concentration and performance data to aggregators to allow for data/risk-based monitoring, and improved public reporting to increase transparency in the mortgage market.

Improved governance and oversight

Improving governance and oversight is critical to successful self-regulation. The MFAA recommends an ongoing process of governance that leads to better consumer outcomes, including independent monitoring and analysis of quality, penalties for poor behaviours including broker exclusion, and data-based learnings applied to recommendations on new remuneration structures, which eventually forms a 'virtuous circle' of incentives, behaviours, monitoring, training and policy formation.

The MFAA will be further developing these options through both its own internal consultative channels, and where appropriate, through the Combined Industry Forum, which encompasses the Australian Bankers' Association (ABA); the Mortgage & Finance Association of Australia (MFAA); the Finance Brokers Association of Australia Limited (FBAA); the Customer Owned Banking Association (COBA); as well as industry representatives from lending, aggregation and broking businesses. This reflects the fact that many of the changes will need to be made at the lender level.

At the next meeting of this Forum, we will be establishing a timeline for implementing change. This timeline will need to reflect the time it will take to fully work up the solutions, assess the unintended consequences, as well as the interdependencies of many of the proposals. It will also need to take into account proposals 5 and 6 which the industry will need to work on collaboratively with ASIC.

The MFAA would like to thank you again for the opportunity to respond to the ASIC Review of Mortgage Broker Remuneration. Should you have any questions regarding this submission, please do not hesitate to contact me.

Yours sincerely

Mike Felton
CEO

ANNEXURE 1

MATRIX OF POSSIBLE SOLUTIONS TO ASIC BROKER REMUNERATION RECOMMENDATIONS

Likely to be suitable
Potentially suitable but unintended consequences
Unlikely to be suitable
Not suitable

#	Name	Description	Advantages	Disadvantages	Does it discourage larger loans?	Overall/Other comment
Recommendation 1: Improving the standard commission model						
1.1	**Pay upfront on drawn amount net of offset (No upfront top up)**	Pay upfront on drawn amount net of offset with no payment ever made for amount in offset account	Reduces the potential for behaviour that may encourage larger loan sizes to be placed in offset	Unintended consequence could be to not pay commission on funds placed in offset for a renovation or deposit on investment property or any other legitimate imminent use	Yes but unintended consequences	Does not compensate brokers for legitimate additional drawings
				Could impact construction loans which would need to be excluded		
				This is a measure that only addresses the use of offset and not the full population of loans		
				Would need checks and balances to ensure that brokers do not delay deposit into offset in order to maximise upfront.		

1.2	**Pay upfront on drawn amount net of offset (with subsequent upfront top up)**	Pay commission on drawn amount less offset balance. In 6 to 12 months (to be decided) pay top up upfront commission based on offset balance at the time of top up but only if the offset balance for materiality purposes is less than a certain percentage (say 90%) of what it was immediately after the loan was drawn. If the offset balance is greater than 90% of what it was at the time the loan was drawn then no top-up is payable. This 10% buffer is to put in a materiality test and to remove any normal fluctuations that one would expect to occur in an offset balance.	Reduces the potential for behaviour that may encourage larger loan sizes to be placed in offset	More complex in requiring two upfront payment calculations and two disbursements by Lenders	Yes, but possibly less so than option 1.1	Most suitable of variations 1.1, 1.2 and 1.3 despite the need to pay twice.
		In order to avoid abuse of the top-up this measure will likely require a timing window that lenders can use to assess the top-up payment so that it is not scheduled to occur on a particular day.	Reduces unintended consequences associated with 1.1	This is a measure that only addresses the use of offset and not the full population of loans		
			The drawing of additional funds and placing in offset can be a very strong solution for a customer and this solution allows that to happen but with delayed payment provided that a minimum amount (say 10% of the amount) is used within a stipulated period.	Always a risk of fragmentation of approach if lenders adopt different solutions here		
				Creates an uncertainty for broker's revenue		
				Would need checks and balances to ensure that brokers do not delay deposit into offset in order to maximise upfront.		
1.3	**Pay upfront on drawn amount (with clawback for non-utilisation)**	Pay upfront on drawn amount and then clawback upfront to the extent offset is not utilised within a period such as 6 or 12 months	Reduces the potential for behaviour that may encourage larger loan sizes to be placed in offset - but possibly less so that measures 1.1 and 1.2.	More complex to administer as requires a clawback in 6 to 12 months	Will have some impact but less so than options	More complex to administer and doesn't immediately reduce broker compensation that may be causing the behaviour.

					1.1 and 1.2 above	Complexity adds opportunity for dispute.
				Clawback is a source of conflict between Lenders, Aggregators and Brokers which we are reluctant to add to.		
				Does not have immediate effect on brokers compensation where it may be causing the behaviour		
				This is a measure that only addresses the use of offset and not the full population of loans		
				Creates an uncertainty for broker's revenue		
1.4	**Broker to disclose the incremental total cost of the additional offset funds over the term of the loan.**	Where a broker has recommended that a customer add funds to the loan size to be placed in offset the broker to tally loan repayments over term including offset then to deduct sum of loan repayments excluding offset with the net balance to be disclosed to the customer as the potential maximum additional costs (principal and interest) of repaying the additional funds over the life of the loan should they be drawn.	Will highlight the true impact of the additional funds over the life of the loan.	Requires additional effort by broker.	Yes	Needs further discussion as to how easily this can be achieved in a manner that ensures accurate disclosure.
		This in essence highlights the incremental repayments related to the offset amount on the assumption it is drawn day 1.	The drawing of additional funds and placing in offset can be a very strong outcome for a customer and this solution allows that to happen provided appropriate disclosure occurs to the customer of the impact thereof.	Could be cumbersome and could confuse clients given that existing disclosures on pre-disclosure statement/contract already disclose the total repayment amount on the loan over its life.		
				Risks a lack of standardisation across the industry in terms of disclosure		
				Not population wide		

1.5	**No upfront commission paid on cash-out**	In circumstances where there is a refinance there is no upfront commission paid on cash out	Will reduce behaviour that encourages larger loan sizes to be placed in offset	Could impact someone wanting to take equity out of home for use as a deposit for investment property with another lender or to pay off higher priced debt for example	Yes	Too many unintended consequences reduces choice
				May encourage brokers to use a single lender with cross collateralisation to avoid cash out which may in effect limit customer choice and not be a good consumer outcome.		
				Could result in broker not being compensated for legitimate loan		
				Could restrict customer flexibility in terms of how they use their funds forcing them to go direct to the bank and cutting out the broker which would unfairly disadvantage the broker and aggregator		
1.6	**Pay upfront for legitimate investment purposes only**	Only pay upfront on home loans and "genuine" investment purposes such as - residential and investment home purchases, home renovation, debt consolidation, financial planning investment e.g. super, any other legitimate investment	Will discourage broker driven increases in loan size for non-investment or general liquidity purposes	Restricts customer choice on what they may use their equity for when using a broker and could force them to go to a lender directly which would unfairly disadvantage the broker and aggregator.	Partially	Too complex and complexity adds opportunity for dispute.
				Could be complex to administer - will need to define inclusions and exclusions		
1.7	**Pay upfront on loan size & LVR (Pivot)**	Pay lower commission % for higher LVR and higher commission for lower LVR around an agreed pivot point e.g. 80%	Discourages brokers from writing higher LVR loans which in turn discourages higher loan size	Results in an inverse relationship between reward and effort (brokers advise higher LVR tend to involve greater effort)	Yes	One aggregator found they earned more when a Lender introduced this type of structure - 1.5 to 2.5 basis points more for a period.
		Example: 95% = .0053 90% = .0057 85% = .0061 **80% = .0065 Pivot** 75% = .0069 70% = .0073 65% = .0077	Aligns to prudential objectives and references in both the ASIC Rem Report and Sedgwick report to LVR. Regulator would argue lower LVR's are a good consumer outcome	Many high LVR loans are not poor outcomes. Often loans for medical professionals are high LVR and very complex in terms of personal financial structure or trusts requiring significant additional work which would not be compensated for in this instance. The LMI work above 80% in itself		There are already measures going this way (such as risk based lender pricing) so brokers are likely to be writing less high LVR loans in future in any event so potentially attacking this twice.

				complicates and adds to workload which again is not compensated for.		
			Correlates to risk weighted capital - higher risk/lower cost to originate	Ignores valid use of tax driven high LVR's in investment property lending - and often where the customer is in fact advised by their accountant or financial planner not the broker.		Unintended consequences on not paying for complexity, potentially affecting (first time buyers) FTB's and investor lending where high LVR's are quite legitimate and have in the past represented up to 40% of broker volume.
			At 70% the broker earns a similar commission to 80% so no incentive to push to the LMI level.	If % differences are less than shown in Column D, LVR might ratchet up or down but when you apply the lower rate to the higher amount it still results in a higher aggregate commission depending on loan size		
			Simple and measurable (existing metric)	Could steer brokers away from consumers such as FTBs that need their assistance most – due to lower reward for effort.		
			Seeks to compensate brokers for lower commission on high LVR by providing higher commissions on low LVR	Disadvantages Insurers as puts further downward pressure on LVR, however that pressure is already there and this measure is just aligning to it.		
				Brokers that consistently write the majority of their business in high LVR loans will be disadvantaged - particularly if FTB's.		
				Could encourage brokers to make greater use of limited guarantees from parties related to consumer.		
1.8	**Pay upfront on loan size & LVR (Cap -say 90%)**	Only pay commission up to a 90% LVR cap except for First Time Buyers (FTB's) which are excluded.	Removes the incentive to arrange LVRs above the cap	Does not discourage brokers pushing customers from say 70% to 80%.	Yes	Concerns brokers would earn less and has no impact under 90%.

			Aligns to prudential objectives and references in both the ASIC Rem Report and Sedgwick report to LVR. Regulator would argue lower LVRs are a good consumer outcome	Could result in brokers earning less which would need to be compensated for in a higher base starting point which I suspect lenders may be reluctant to do.		
			Simple and measurable (existing metric)	May not adequately compensate for effort		
			Partially correlates to risk weighted capital - from 90% higher risk lower relative cost to originate (in reality cost is static from 90% whilst revenue increases)	Many high LVR loans are not poor outcomes. Often loans for medical professionals are high LVR and very complex in terms of personal financial structure or trusts requiring significant additional work which would not be compensated for in this instance to the extent LVR exceeds 90%.		
			Simple and measurable (existing metric)	Does not fully compensate brokers for valid use of tax driven high LVR's in investment property lending - and often where the customer is in fact advised by their accountant or financial planner not the broker.		
				Disadvantages Insurers as puts further downward pressure on LVR, however that pressure is already there and this measure is just aligning to it.		
				Brokers that consistently write the majority of their business in high LVR loans will be disadvantaged. Exclusion of first time buyers will however assist.		
				Could encourage brokers to make greater use of limited guarantees from parties related to consumer.		
1.9	**Pay upfront based on loan size & complexity (as proxy for effort)**	Pay higher commission for more complex deals and lower commission for less complex. Complexity could be based on income level and source.	Rewards for effort	Complexity would need to be defined in terms that are as simple as possible so as to avoid over-complicating the calculation	Not on its own	Too complex when used with LVR and probably little benefit on its own. Complexity adds opportunity for dispute.

			Can be used to moderate negative impact of LVR measure relative to effort	Only worthwhile if used with LVR, however if used with LVR then likely to be too complex		
				Does not compensate for effort on deals that do not settle i.e. effort does not necessarily lead to economic value		
1.10	**Link upfront and trail (or other aspect of rem such as broker clubs) to a quality measure (aspirational) - linked to recommendation 6**	As part of a cycle of continual improvement, there could be an industry wide quality metric that results from a standard industry audit and is linked to remuneration to encourage a culture of compliance and continual improvement. Would need to be standardised and portable. Ideally linked to consumer outcomes and compliance (responsible lending, interim assessment, filenotes, justification for I/O etc.).	Obvious attraction is the self-assessment by the industry and continual improvement.	Hard to standardise across industry both in terms of criteria and the way they are applied	No	Has a number of attractions but only realistic in time and if there is a degree of consistency in the industry. Fits more into recommendation 6 than recommendation 1 as more governance related.
			Could use the quality measure to link to aspects such as entry to broker clubs	Very difficult to implement across the industry		
			Provides a more balanced scorecard	Risks subjectivity of assessor		
			Strong direct incentive to behave appropriately	As audit will be data/risk based could result in an above normal level of monitoring for customers that for example have high portion of investment loan/ high LVR business		
			Potential for better applications which is a good outcome for consumer, regulator, broker and lender			
1.11	**Standardisation of upfront**	All Lenders pay the same upfront %	Removes Lender based Conflict of Interest	Restricts competition	No	ASIC communicated with MFAA not looking to standardise or cap
				Limits ability to pay higher commissions for more complex products		

1.12	**Reduce Upfront/ Increase Trail**	Reduce upfront % and increase trail %	Could increase consumer confidence that more of the funds a broker receives is for service over time.	Delays revenue and limits economic attractiveness for new entrants potentially reducing competition	No	Would reduce the attraction of becoming a broker
				Higher Barriers to Entry		
1.13	**Flat Upfront Lender Fee plus % trail**	Industry pays an upfront flat fee regardless of loan size or broker location	Removes any incentive to boost loan size	No correlation to economic value produced by broker.	Yes	Not viable for reasons shown
		Please note - Advantages and Disadvantages listed in columns E and F relate to upfront only	Easy to administer	Results in one broker cross-subsidising another		
			Correlates to effort	Results in a lender using high value deals to cross-subsidise low value deals (or pushing up APR on lower value deals to compensate)		
				Tiered flat lender fee could result in an even higher conflict of interest as one approaches next borrowing tier		
				Does not link lender costs to lender revenue		
				Linking remuneration to loan size has best alignment of objectives between Lender and Broker. Flat fee does not align objectives		
				Will discourage new entrants to the industry and reduce competition		
				Could results in split loans		
				No correlation to different broker cost structures around the country (e.g. Adelaide v Sydney)		
				Could make broking non-economical in certain jurisdictions		

				If the objective of a flat fee is to correlate to effort, it however ignores the effort put in on deals that do not settle.		
				Small loans/top-up loans would be non-economical for lenders and could be compensated for by higher interest rate or application fee to consumer which would be a potentially poor outcome.		
1.14	**Collar**	Combines a flat basic fee for a base amount say $300k and then a percentage between $300k and a selected loan maximum.	Partially removes the focus on loan size, but only for loan sizes that are below or above the collar	Will disadvantage certain brokers that write high value loans	Only discourages larger loans above the maximum	Limited link to economic value
				Only partial correlation to economic value produced. Not correlated where loan size is above or below collar.		
				Results in one broker partially cross-subsidising another		
				Does not link lender costs to lender revenue		
				Linking remuneration to loan size has best alignment of objectives between Lender and Broker. Collar only partially aligns between collar limits.		
				May discourage new entrants to the industry and therefore reduce competition		
				Uneven correlation to different broker cost structures around the country (e.g. Adelaide v Sydney)		
				Suffers from a number of the same disadvantages described in 1.3 above but just to a lesser extent		
				Can't be equally applied to all states		

				Small loans/top-up loans would be non-economical for lenders and could be compensated for by higher interest rate or application fee to consumer which would be a potentially poor outcome.		
1.15	**Remove lender APR discounts for loan size**	Currently Lenders offer discounts to customers for higher loan sizes which incentivises brokers to increase loan size. **Note** - Other measures in 1.2 and possibly 1.4 likely to remove the need for this one	Would discourage loan size	Removing these discounts would more likely be a poor outcome for consumers who may benefit from borrowing a small additional amount.	Yes	Creates conflicting objectives for the broker, on the one hand they are providing advice that reduces the consumer's APR which is a great outcome but on the other hand they are suggesting a larger loan size which regulator may see as a poor outcome. If there is a measure introduced to pay net of offset and/or additional disclosure on offset amounts then that should negate any benefit to the broker from this behaviour and remove the need to cease this type of Lender offer (we get a good consumer outcome and broker is not rewarded for the behaviour unless funds are drawn within 6 to 12 months). If no offset measure is agreed then greater consideration needs to be given to this one.
1.16	**Removal of brokers ability to reduce customer application fee/Interest rate by discounting upfront commission or trail**	Having this ability presents a conflict of interest and consideration can be given to removing.	Removes conflict of interest	If implemented would result in a consumer not getting a reduction in application fee or interest rate which is likely to be a poor outcome	No	Consumer benefit likely to outweigh the conflict in terms of advantages/disadvantages
				Brokers could in any event rebate the fee themselves so in reality no point in implementing		

1.17	**Adjust lender accreditation removal to include retraining step**	Removal of lender accreditation of a broker to be reviewed to ensure that hard edge is removed and another step is introduced in the process. Terminating for conduct, quality and educational purposes fine, but we need an alternative (e.g. further education) for usage/volume as impacts broker's ability to service existing clients and can result in behaviour that diminishes choice. One alternative is that broker needs to complete additional training or re-education by a certain period and that their accreditation can only be removed if that doesn't occur. But clearly there needs to be balance in the discussion.	Removes potential reduction in consumer choice in order to maintain accreditation		No	"Hard edge" needs to be removed to ensure consumer choice is not impacted and that brokers can service their back book
			Will ensure a broker can service existing clients with a particular lender			
1.18	**Referrers need to be more actively regulated**	Referrers are paid too much relative to what they do with too little regulation and minimal duty of care. Playing field needs to be levelled.	Would level the playing field between brokers and referrers and also potentially strengthen consumer outcomes			

Recommendation 2: Moving away from bonus commissions and payments						
2.1	**No Lender VBI direct to Broker**	Creates heightened conflict and to be urgently done away with	Can be implemented immediately	Reduces broker remuneration in certain circumstances where brokers are still receiving VBI from lenders		Immediate solution
			Removes the conflict of interest			
			Improves consumer choice			
2.2	**No pass through to broker of Lender VBI being paid to aggregator**	Creates heightened conflict and to be urgently done away with	Can be implemented immediately	Reduces broker remuneration where brokers are receiving VBI from the aggregator		Immediate solution
			Removes the conflict of interest			
			Improves consumer choice			
2.3	**Remove Volume Bonuses and replace with a bonus based on balanced scorecard including other metrics such as quality**	Volume creates a heightened conflict of interest which may affect consumer choice. Industry needs to phase out bonus paid purely on volume and replace with bonus based on balanced scorecard including other determinants such as quality	Reduces potential for conflict of interest	Takes away aggregator funding used for compliance, training and education (hence importance of replacing)		Will take some time to implement given will need to be negotiated between various aggregators and lenders
			Improves consumer choice			
2.4	**Remove campaign bonuses**	Campaign bonuses shown to work and created heightened conflict of interest which may affect consumer choice	Removes the conflict of interest	Reduces broker/aggregator income		Immediate solution
		Where customer receives benefit such as lower APR then fine to remain but aggregator and broker cannot receive the benefit or elevated conflict of interest.	Improves consumer choice			
Recommendation 3: Moving away from soft dollar benefits						

3.1	**Broker Club entry by invitation based on balanced scorecard and exit not related to volume. Also, broker club benefits to excludes additional commission or reduced clawback.**	Volume criteria to get into a broker club provides a conflict of interest that could diminish consumer choice - "hard edge" needs to be removed.	Reduces the potential for conflict of interest	Removes additional commissions and reduced clawbacks that brokers may have received in the past but provides a solution for the retention of broker clubs rather than their complete removal		
		Entry should potentially be based on invitation and a balanced scorecard with a percentage based on volume (say 30%) and balance based on other metrics. Removal should not be based on volume but on poor conduct, poor quality or not completing education then the "hard edge" will have been removed.	Improves consumer choice			
		In addition, benefits of broker clubs to be reviewed to ensure that they do not deliver increased commissions or reduced clawbacks to brokers which create a conflict of interest and may diminish consumer choice. Fine to deliver greater APR discounts and other benefits to consumer.	Allows good brokers to continue to receive an improved level of service			
		Provision for membership to be paused when broker is out of industry for a period due to maternity leave or ill-health.	Removes the "hard edge".			
3.2	**Broker club entry based on volume across the entire aggregator panel**	In essence the aggregators to advise which of their brokers are top performing. In addition, benefits of broker clubs to be reviewed to ensure that they do not deliver increased commissions or reduced clawbacks.	Removes the need to push next deal to a lender to maintain membership of a club	Volume with an aggregator only equates to potential volume with a lender		

			Improves consumer choice	Aggregators get to decide entry into clubs which takes some control away from the broker. Brokers unlikely to be happy having to get Aggregator tick of approval.		
3.3	**Lender to Broker Soft Dollar including conferences- Soft dollar benefits (other than broker club) provided by a Lender to a Broker to be recorded and disclosed, not to be linked to volume, and eligibility to be determined by balanced scorecard.**	Lender soft dollar benefits provided to brokers (other than broker clubs) should not be linked to volume and where a soft dollar benefit from a lender in excess of $350 (proposed) is made, such benefit should be recorded by the broker in a register held by the aggregator (or broker where broker only deals directly with lenders). Once an amount has been recorded in the register for a lender then the broker must disclose the cumulative total of such benefits in the preceding 12 months from the lender in question.	Results in improved disclosure that is closer to FOFA arrangements	Requires systems and efforts to track and report		
		Eligibility for soft dollar over proposed level of $350 should be based on a balanced scorecard where volume only forms a portion (e.g. 30%) and other metrics make up the balance.	Reduces focus on volume and introduces a balanced scorecard	Needs consideration for unintended consequences. Obviously don't want to limit a Lender's ability to develop a relationship with a new broker that currently does zero volume but has significant potential.		

3.4	**Aggregator to Broker Soft dollar including conferences -Soft dollar benefits provided by an aggregator to broker need to be based on performance across total panel of lenders and products not based on specific lenders and products**	In addition, aggregator event sponsorship should be offered to a broad range of lenders (all lenders on panel ideally) and not be lender specific. Training & education events should seek the broadest broker coverage possible. Where an aggregator is selectively inviting a sub-set of brokers to a Leaders Forum or similar, selection should be based on a balanced scorecard where volume only forms a portion (e.g. 30%) and other metrics make up the balance. As aggregator soft dollar is across the panel of lenders no inclusion in the register or disclosure to consumer is required.	Still allows good brokers to be rewarded for activity across the lender panel			
			Preserves important training and education			
			Reduces focus on volume and introduces a balanced scorecard			
3.5	**Lender sponsorship of aggregator and broker events**	See further comments in 3.4				
Recommendation 4: Clearer disclosure of ownership structures						

4.1	**Ownership disclosure to be provided where Lender has shareholding in aggregator or broker group and is able to exert influence on the aggregator or broker group (Need to agree specifics of what that disclosure should look like).**	Broker likely to need to disclose both their aggregator and the Lender that ultimately owns them. Could set at > 20% or where shareholder has influence. Further discussion needed.	Improves disclosure			
		Further guidance to be taken from ASIC on required disclosure				
4.2	**Lending entity behind white label products to be clearly disclosed.**	Transparency required in white label arrangements	Improves disclosure			
Recommendation 5: A new public reporting regime						
5.1	**Broker unique identifier is mandatory for each loan funded**	A unique identifier of the broker that has intermediated a loan must be provided to the lender with the application and stored by the Lender throughout the life of the loan and for a period post payout (period to be agreed). May require a solution for employees of a licensee that are not appointed credit reps to avoid multiple loan writers using the same ACL number.	This will allow Lenders to identify exactly which broker originated a particular loan so that appropriate data/risk based monitoring can occur.	Authorised reps currently have a number but employees of a licensee may not have one.		
		Ideally each broker should in time be using a single identifier across all lenders		Could require work and cost to implement single number across the industry		

5.2	**Lenders to provide all key loan data to the Aggregator to allow for a data and risk based approach to monitoring under recommendation 6**	Lenders to provide aggregators with regular reporting on the key concentration risks and performance reporting by broker using broker identifier.	Allows a risk/data based approach to monitoring			
		Exact metrics to be determined				
5.3	**Improved public reporting to increase transparency in the mortgage market**	Increased reporting on: - Value of aggregator remuneration - Average pricing of homeloans originated by brokers - Average pricing of homeloans by lenders across the various channels - Distribution of loans by brokers between lenders to give consumers an idea of the range of products offered by brokers within the network.	Improves transparency, trust and confidence	To be meaningful, this reporting will need to be standardised across the industry.		Industry to work with ASIC on what data should be tracked and reported here. Only data that is useful and drives positive outcomes should be required.
		Further work needed between industry and ASIC to define what would be most practical and beneficial here given ASIC's Rem review experience.				
Recommendation 6: Improved Governance and Oversight						
6.1	**Improved reference checking protocol to be implemented by aggregators when a broker joins**	More robust reference checking needed when a broker joins an aggregator	Will restrict the movement of brokers that may have left an aggregator for adverse reasons	Needs to be fair and robust process to ensure that a broker is not unfairly restricted in their ability to change to another aggregator.		
6.2	**Broker exclusion for misconduct (to the extent possible)**	Consideration to be given to developing a mechanism that can remove brokers from the industry for significant poor conduct	Will strengthen the professionalism and integrity of the overall broker industry driving trust and confidence.	Needs to be fair and done in a manner that does not pose risk to brokers or the organisation managing the process		

		Will require further discussion between ASIC and industry in order to develop a potential solution as industry unlikely to be able to achieve a solution in isolation.	Will reduce risk or poor consumer outcomes			
6.3	**Risk and data based approach to monitoring with remedial action to be taken based on monitoring outcomes**	Lenders and aggregators to be responsible for monitoring brokers using a risk based approach using loan and performance data provided by lenders.	Self-assessment strengthens the industry and is critical to the cycle of continual improvement	Costly. Need to decide how this cost will be recovered		
		Will require a conduct scorecard		As audit will be data/risk based, could result in an above normal level of monitoring for customers that for example naturally have high portion of investment loan/ high LVR business		
		Aggregators to perform the file reviews on authorised representatives				
		An independent party to perform the audit on brokers with their own licence (the MFAA may in time be able to provide a service in this area with economies of scale if required)				
		Remedial action to be taken on monitoring outcomes including further education and training, reporting to relevant entities and associations, further action to potentially exclude.				
		Tailor monitoring to possible behaviours rem structures may drive.				
6.4	**Increased client surveys post acquisition**	Part of a consumer focussed service culture to be conducted by Lenders, Aggregators and Brokers	Provides feedback loop that is critical to self-assessment and continual improvement			

6.5	**Increased Mystery Shopping**	Industry should perform increased level of mystery shopping as part of overall monitoring process	Provides feedback loop that is critical to self-assessment and continual improvement	Cost will need to be recovered		
		MFAA could assist in managing suppliers on behalf of industry				
6.6	**Approval process for new remuneration structures**	Lenders, aggregators and broker businesses (at an organisation level) to embed the principle of obtaining good consumer outcomes as a guiding factor in the design of their remuneration arrangements	Limits the potential of there being structures that will drive poor behaviours and outcomes			
6.7	**Combined Industry Forum to remain in place to manage the self-regulation and ongoing self-assessment of the industry and to recommend further action as required.**	Part of process of continual improvement which is critical to self-regulation	Self-regulation strengthens the sustainability of the broker industry and drives consumer trust and confidence	Risk anti-competitive behaviours which need to be closely monitored		
		Ensure proposed changes are not reducing competition				
		Evaluate consumer outcomes further				
		Decide vehicles in order to implement the industry change e.g. Code of Conduct				
		Take time to understand impact on behaviour of intended actions – understand unintended consequences and behavioural economics. Getting it right is key.				

ANNEXURE 2

Strong banks – strong Australia

MORTGAGE & FINANCE ASSOCIATION OF AUSTRALIA

CUSTOMER OWNED BANKING ASSOCIATION

Media Release

Mortgage industry comes together to progress ASIC proposals

Sydney, 14 June 2017: Representatives from the mortgage industry have begun a process to ensure that incentives and governance arrangements are aligned with good outcomes for customers, in response to ASIC's report on mortgage broker remuneration.

In a first for the mortgage industry, the Australian Bankers' Association (ABA), the Mortgage and Finance Association of Australia (MFAA), the Finance Brokers Association of Australia (FBAA) and the Customer Owned Banking Association (COBA) held a discussion forum with key industry participants including bank and non-bank lenders, aggregators and brokers to progress reform.

The forum, held on Friday 9 June in Sydney, was recognised by participants as an opportunity for the industry to understand the key issues in response to ASIC's proposals for mortgage broking; the potential impact to aggregators and lenders; and the overlap with the Sedgwick Review.

ABA Executive Director – Retail Policy Diane Tate said, "This first meeting of the forum was an important step for the industry to work together on options for an industry based response to calls for changes in the mortgage industry.

"We have heard these calls to change incentives and governance arrangements and we look forward to working with the industry, in consultation with the government and subject to all competition law obligations, on reforms to support good customer outcomes."

MFAA CEO Mike Felton said, "The MFAA sees this as a crucial step in the process of determining how we as an industry respond to the challenges of addressing ASIC's proposals on broker remuneration and how we ensure the sustainability of our industry going forward.

"This meeting demonstrates that our industry is serious about self-regulation and has the maturity to work together across different stakeholder groups to effect the required change and ensure customer outcomes continue to remain front of mind."

Peter White, Executive Director of the FBAA, said, "This is a unique step forward for our industry to see everyone sit around this table with a clear view to support best practice and good consumer outcomes from this process, whilst supporting an industry sector that has positively delivered so many positive outcomes to the lending landscape over the past 27 years."

COBA Chief Executive Mark Degotardi said, "Brokers are a valued part of the mortgage market. We're keen to work with industry to ensure that this channel continues to work effectively for consumers."

Further discussions with forum participants will be held in the coming months, with all participants committing to work in consultation with Treasury and Government stakeholders on an industry led response.

ENDS