**Australian Government**

**Productivity Commission**

**PRODUCTIVITY COMMISSION**

**INQUIRY INTO COMPETITION IN THE AUSTRALIAN FINANCIAL SYSTEM**

**MR P HARRIS, Presiding Commissioner**
**DR S KING, Commissioner**
**MS J ABRAMSON, Commissioner**

**TRANSCRIPT OF PROCEEDINGS**

**AT 530 COLLINS STREET, MELBOURNE**
**ON MONDAY, 5 MARCH 2018 AT 10.47 AM**


© C'wlth of Australia

# INDEX

**Page**

**SUNCORP GROUP** **181-200**
MR DAVID CARTER

**LATERAL ECONOMICS** **200-214**
MR NICHOLAS GRUEN

**CONSUMER ACTION LAW CENTRE** **214-229**
MR GERARD BRODY

**FINANCE BROKERS ASSOCIATION AUSTRALIA** **229-250**
MR PETER WHITE

**MS MARIA RIGONI** **250-262**


© C'wlth of Australia

**MR HARRIS:** So I think I'm going to first check that we have sound and it's going okay. Sound's happy. And we have vision and everyone's happy on vision. So I'm going to open the Melbourne hearings for this inquiry of the Australian Financial System or Competition in the Australian Financial System. As people will know, we released a draft report on this in early February and we're due to offer the government a final report by 1 July. I should acknowledge we meet today on the traditional lands of the Wurundjeri people of the Kulin nation and I pay my respect to their elders past and present.

I'm Peter Harris, I'm the presiding commissioner and chairman of the Productivity Commission and I have with me Julie Abramson and Stephen King who are the other commissioners of the inquiry. Finance is so big we need three of us. So the purpose of the hearings today will be to cover off comments received from submitters and from other registered parties registered today on our draft report. Today's hearings follow hearings we had in Sydney last week. We conduct these hearings in a reasonably informal manner, but I want to remind participants first that a transcript is being taken, so, second, try not to be defamatory; we will interrupt you if you're getting towards the point of defamation. We surprisingly had that happen once or twice before, or getting close to it.

And also I should remind participants that although they're not on oath that Productivity Commission legislation does require participants in hearings to be truthful in their remarks. As I said a little earlier, we are livestreaming so there will be people taking down comments outside. We don't prevent anyone from in the room from participating via various social media arrangements, but we do not allow photography other than by prior permission or indeed TV broadcasting by prior permission but today we don't seem to have that, so I don't think it'll probably matter terribly much. There will be a transcript provided on our website in a week or so of these remarks for people who are looking for it in hardcopy.

And then finally I have to tell you, under OH&S arrangements, if there is, an alarm system, you'll be able to observe us following the alarm system and proceeding via the green exit signs and taking advice of wardens and assembling supposedly in Enterprise Park down the road there, but I'm sure half of you will go for coffee somewhere else more easily. Now, let's hope that the alarm system doesn't sound. And our first person this morning I think is Suncorp. Could you identify yourself, please, for the court?

**MR CARTER:** Yes, thank you, David Carter, the CEO of banking and wealth at Suncorp Group.

**MR HARRIS:** David, do you have some opening remarks to make?

**MR CARTER:** If I may, thank you. Firstly, I'd like to thank the commissioners for the opportunity to appear at today's hearing. Suncorp strongly supports the Productivity Commission's work in relation to competition as we see the enquiry's an important opportunity to initiate reforms which will ultimately drive better our customers. In our view, one of the better ways to deliver this is by improving the ability of all banking institutions to compete on a level playing field. The Commission's draft report is a


© C'wlth of Australia

comprehensive document which identifies a large number of potential issues and possible improvements.

Many of the impediments to competition that we raised through our initial submission have been addressed in the draft report. We are therefore largely supportive of the Productivity Commission's proposals and welcome the opportunity to consult further on this important topic. Before turning to some key issues for smaller banks, like Suncorp, I would also like to take a moment to acknowledge the strengths of Australia's financial system. While we see opportunities for improvement, our financial system is far from dysfunctional and has largely operated well in serving the interests of all Australians. Australia's regulators have ensured that financial stability has been maintained and this focus undoubtedly positioned the country solidly through the global financial crisis.

Customers have been safe in the knowledge that their hard-earned money is protected by responsible banks operating within a well-functioning prudential framework. While the major banks do hold a dominant position in the market, having four strong and globally recognised banks operating in Australia is also a strength for our system and one that in many regards has benefited our economy. As a net capital importer, access to international funding markets is essential, and the scale and profile of our major banks improves their ability to gain access to these markets while simultaneously freeing up access to domestic markets for smaller banks.

In many regards, this equation strikes a good balance for all parties, and we should be weary of imposing any significant changes on these market structures given the risk of unintended consequences. It's a symbiotic relationship that may very well help to insulate Australia from future shocks and disruptions in the global economy. However, there are several areas where we continue to believe the prudential and regulatory settings could be adjusted to enable smaller banks to compete more fairly against the major banks. In particular, we continue to hold concerns about funding costs, risk weights, macroprudential interventions and the disproportionate burden of regulations on small institutions.

We seek reforms in these areas as we believe positive changes will allow smaller banks to more effectively bring tension to the sector which will inevitable spur greater innovation, choice and deliver better outcomes for all customers. APRA's recent paper on implementing Basel contains some encouraging proposals around risk weights including potential reductions for some low-risk residential mortgages held by standardised ADIs. However, uncertainty remains around final calibrations, particularly for some IRB or internal ratings-based settlements. Suncorp has already made a significant investment in developing the risk models needed to achieve IRB accreditation and we would not want to be penalised for being a regional bank leader in this area.

Risk weights have an impact on decisions that banks make about lending products, and it is important the settings are calibrated in a way that does not undermine consumer outcomes. Macroprudential caps on investor and interest-only lending continue to distort competitive tensions in lending markets and have allowed those with the largest investor and interest-only portfolios to use their pricing power in these areas to offset particularly


© C'wlth of Australia

sharp pricing on lower risk owner-occupied principal-and-interest loans. We welcome the Productivity Commission's findings in the draft report that banks' ability to compete on price have been constrained significantly by macroprudential interventions. While we maintain concerns about the caps, we have been encouraged by APRA's recent comment that the investor cap was potentially becoming redundant.

The investor cap has already had a significant impact on aggregate lending levels across the industry and the other measures introduced by APRA and ASIC have addressed regulator concerns around lending standards. As such, we believe the investor cap is no longer needed and that its removal will once again allow banks to compete for this type of lending. We continue to observe the non-ADI sector has benefited from macroprudential caps and has been able to fill some of the gap created by the reduction in credit to investor/ interest-only, and we continue to observe that that sector is subject to much lower capital and regulatory requirements and has enjoyed significant growth and commensurate return.

Further, the major banks continue to hold significant funding cost advantage cost advantage over their smaller rivals. While their size and scale will always give them a price advantage in funding markets, we believe that the three notch credit uprating upgrade they received due to the perception of government support provides them with an additional unfair advantage on top of this. It does beg the question as to how that can be good for customers. Smaller banks' ability to compete on price ultimately is driven by their ability to source capital to support growth in both the retail mortgage and small business lending markets, which is typically the focus of those banks.

The owners of capital require suitable return or return on equity. The return is influenced by funding costs on the revenue side and by the costs of running the business on the expense side. The equity is influenced by the risk weights used to determine capital requirements. Large banks have scale advantage and this is a natural economic outcome, however this has been compounded by increased regulatory activity and the cost associated which is likely disproportionate for smaller banks. Post-GFC, ROEs in smaller banks have averaged closer to half those in the large banks.

In order to witness greater price competition it would seem necessary to first deliver a return on equity that can attract incremental capital to the smaller banks. Finally I would like to emphasise that competition in the banking sector is about far more than price competition. While price will always be an important consideration for many customers, other important factors such as product features, customer service and the reputation of the institution itself are often highly relevant. What is important is that customers are empowered to choose a product or service that provides them with a combination of price and other factors that best meet their needs.

In this regard we believe that the broker sector continues to play an important and valuable role providing customers with additional choice and service which is often more than just about simply identifying the cheapest product. Thank you again for the opportunity to be here today and I welcome your questions.


© C'wlth of Australia

**MR HARRIS:** Thanks. So can I start with return on equity? You may have observed last week in Sydney a number of the larger banks persisted in arguing that because return on equity had fallen in recent times, somehow that was an indicator that competitiveness was increasing, that seemed to be the implication. And we had some doubts about that and we had observed - or I observed at one point that we did start out with the banking analysts themselves to ask, "What are the preferred logical measures here of profitability and other performance in markets?"

So let me just ask you this in terms of return on equity: equity's been increased by regulators post the GFC; if there's been, roughly speaking - not true in the case of smaller banks but large banks it is roughly true - no real change to net interest margins nor any other alternative big increase in costs, return on equity falls simply because of the action of the regulator, not actually because of anything that's happened in a competitive sense in the marketplace. Would that be correct or have I sort of broadly misunderstood something here?

**MR CARTER:** No. I think in the absence of the R changing much then if E goes up, ROE must fall. I guess the key question is whether capital remains attracted to a lower return on equity, and one would argue in the current low-yield environment double-digit ROEs or mid-teen ROEs are a relatively attractive return for what is a relatively safe industry.

**MR HARRIS:** Yes, yes, so - I mean, it's not - we wouldn't dispute that ROE is of relevance, it's more a question of it wouldn't be necessarily a primary way of judging competitiveness in a market. Certainly - anyway, that's the perception I hold currently. I'd be happy if anyone else who also is going to contribute submissions - he says talking with a broadcast - who wants to dispute this, I'd be very interested in getting some better information on that as well. Stephen, do you want to ask any - - -

**DR KING:** Yes, can I - I just wanted to clarify, David, you mentioned the IRB approach and you were partly down that route. It wasn't quite clear to me, are you concerned - what are your concerns in changing or in - just on Basel recommendations or the direction that in APRA's discussion papers the risk weights are going?

**MR CARTER:** Yes, I see a clear intention from the regulator in APRA to try and move the risk weights closer together. It's very clear in the proposals what the implications for standardised banks are, in respect of small business, a slight improvement in risk weights which should be positive for returns in that segment and/or competition. In the housing side I see in a standardised - some movement to try and improve the competitiveness for highest quality mortgages with a new minimum, if you like, of 20 per cent. Large banks can still write the best quality mortgages at a much smaller number, potentially half the capital, so the marginal deployment of your funds is potentially still more lucrative as an advanced bank.

What I also see is the proposal for investor and interest-only lending: a 50 per cent loading designed to recognise that those loans over time show high-risk characteristics, which is probably true, they probably do show high-risk characteristics. However, in the ratings-


© C'wlth of Australia

based approach I see a correlation factor change which equates to something in the order of 22 per cent loading for doing investor and interest-only, which again would seem to recreate a little bit of an imbalance and make it relatively more attractive, all things being equal for the advanced banks, being the four large banks, to write investor and interest-only lending.

So what we need to now see is some of the detail, which in fairness to APRA they have said they need to work through in order to recalibrate their unquestionably strong outcomes by asset class. The challenge for us all will be the residential mortgage and small business lending segments which is where, you know, one would hope most of the small banks are focusing their effort, being relatively lower risk, easier, less complex lending.

The challenge will be if that is - if in recalibrating somehow that recreates, you know, mismatching the playing field again. So, for example, APRA could choose to calibrate in the corporate end of the market, which will not have much impact in terms of the smaller players.

If I may then, just as Suncorp, we and probably at least one other have spent several years now building the models and taking a path towards advanced accreditation, and whilst we find our dialogue with APRA very constructive, I would say that significant changes to the basis for models and/or the models themselves tends to cause us to have to re-spend an amount of time and money. Existing advanced banks do not lose their accreditation whilst they recalibrate, but a bank who has not achieved it may find that they have to re-serve some time where their models are stable before they can achieve accreditation.

**DR KING:** Yes. Just to follow up on that: so internally, when you make that decision whether to continue to pursue accreditation ...(indistinct)... bank or not, it’s a significant investment. Presumably the greater the difference in risk weights, particularly on that residential and SME sector, the bigger the difference in the rates the more incentive Suncorp has to - - -

**MR CARTER:** Yes.

**DR KING:** - - - make that investment, because it will see a return on that investment.

**MR CARTER:** Yes.

**DR KING:** So I get worried when people say, “You’ve got to read” - and it’s been suggested by previous enquiries the rates be brought closer together for competition reasons when there’s an investment behind those ...(indistinct)...

**MR CARTER:** So we believe there should be an incentive to be an advanced bank and we as a bank would certainly argue that we have benefited from the investment and better understand the risks in the portfolio and has led us to make better decisions which will, you know, contribute to the stability of the system.


© C'wlth of Australia

The advantage of advanced in our — from where we sit at the moment — is in your future origination which should enable you to grow and therefore compete more assertively in the market. There is a one-off — as far as we can see at the moment — a one-off impact when you convert, if that makes sense, and therefore a rational investor, a rational board would want to see what the payback period looks like if one had to, for example, increase capital levels initially.

Now, we don't perceive there is a reduction in capital on conversion to come, and that is partly a reflection of lots of change in requirements over time and unquestionably strong, but whether there is a significant or small increase on conversion will depend somewhat on the finalisation of the paper that issues in February from APRA.

**MR HARRIS:** So just sticking with risk weights then - you're about to head off?

**UNIDENTIFIED SPEAKER:** Yes.

**MR HARRIS:** - - - that attitude on risk weights that we tried to express in the draft report was to search for areas where risk-weighting could be varied in a way that might actually reduce costs rather than increase them, and there seems to have been for, you know, I'm sure quite rational reasons, but nevertheless that the pressure prior to us putting in a draft report always seemingly being towards - if there was a problem with risk weights then we'd want to raise them because that would make us even safer. And it doesn't seem to be a - you know, an approach that recognises sufficiently the impact on competition that can come from raising prices; I mean, at the margin the potential borrower is dissuaded and activity is reduced, and so you've got less demand in a marketplace and consequently it is less demanding.

**MR CARTER:** Yes.

**MR HARRIS:** Less competitive pressure from the consumer side, anyway. So it did seem a little imbalanced. So we had two risk weighting propositions in our draft report: one, to propose gradations in the case of homebuyers, and therefore, you know, its variability in that area, and the other in relation to small business lending. Do you have a comment at all on either of those?

**MR CARTER:** Yes, maybe I will and then maybe just to start at a high level. I think the purpose of the risk weights was to encourage banks to focus their risk taking on the lower risk activity, and it has been so effective in this country that everyone has focused on what was the lowest-risk activity, which was residential housing, but unfortunately at a system level that has moved a lot of capital into residential housing and created some - arguably some imbalances, and whether that manifests in house prices or in expansion and debt levels in households or whatever is for others who are more trained in economics than me to opine on, but - now, risk weights can therefore be being used for two purposes.

One is to accurately measure the risk to the system and ensure capital levels are appropriate to protect the depositors in the institutions, which at the end of the day is the primary


© C'wlth of Australia

purpose of the prudential regulator; the other is they can be also used to influence where the marginal dollar of capital is deployed and potentially help support taking heat out of housing markets and certain cities. So I think at a macro level one has to be clear on what the purpose of the risk weights and adjustments is going to be for. We see the proposals in the paper that APRA issued recently for small business as being positive for small business lending and reduction broadly from 100 per cent risk weights to 85 per cent, all things being equal reduces the amount of the E in the ROE equation so that should enable slightly greater competition in terms of pricing and margin.

On the residential side, again, I think there's a dilemma in managing the systemic risk of having too much capital targeting one particular asset class and discouraging over-exuberance in perhaps that asset class because the returns are too attractive. So that's an interesting tension for people to have to try and manage particularly compounded at the moment by very, very low interest rates; and history shows when interest rates are very low and creditors freely available, such as would be encouraged by low capital ratios, asset prices tend to increase rapidly, and one could argue we have seen that particularly in Sydney and Melbourne over the last 36 months.

**MR HARRIS:** Yes. I guess the reason we're interested in this though is this tension that APRA has to manage between system stability objectives of risk weighting and supposedly impact on competition. The question is, we spend our time trying to look for these opportunities that might be less evident, perhaps, to a regulator that has such a clear-eyed focus on stability and unquestionably strong.

There seem to be opportunities there, and they also seem to be opportunities that might allow these risk-weighting gradations to occur, as I said, that - differences in loan to valuation ratio could potentially be expressed in slightly different risk weightings without, I would have thought - as long as you're calculating it reasonably wisely without damaging the system stability because they're well-judged based around additional information, consumer credit is now going to be improved substantially by sharing information across a financial system in a way it hasn't been before, artificial intelligence enables people now to more accurately focus on different classes - - -

**MR CARTER:** Yes.

**MR HARRIS:** - - - of borrowers. The small to medium enterprise, a shift we proposed does actually in part logically have a foundation in utilisation of those sorts of techniques, greater knowledge of different classes of borrower rather than just treating a borrower as a small enterprise and therefore for all small enterprises it's the same, the only question is: do they have a house or not? In which case they get one kind of loan if they get a house, another kind of loan or maybe no loan at all if they haven't got a house.

This ability to wisely judge information that is available in a financial system, at least in those areas that we concentrated on did not seem to be well-reflected in the risk weights. Now, is that ever going to come out in these APRA papers, do you think?


© C'wlth of Australia

**MR CARTER:** I think the IRB model does enable one to do that and discriminate risk at a much more granular level. I think that's as applicable in small business as it is in residential mortgages. I think loan-to-value ratios, which is what APRA is sort of moving to propose now, are a useful tool, they are a bit crude, they do not go to the credit - underlying credit quality of the borrower, merely the equity they have in the property which - and look, there is a correlation between equity and credit worthiness, but it is a bit imperfect.

Comprehensive credit reporting which will - and more open data and more sharing of people's credit histories will generally be a positive in terms of discriminating risk; having said that, there is a valid concern, I think, about vulnerable people and the disadvantaged - financially disadvantaged people in the community about comprehensive credit reporting potentially disadvantaging them further and making it harder for them to access mainstream credit which is something, as a society, I think it would be important for us to mitigate, much like we use social welfare to mitigate people who suffer disability and other things in the country.

**MS ABRAMSON:** Peter, can I just - David can I just follow up on the SME lending, and I apologise if I haven't got this quite straight, but if with the change in the weight it frees up more capital to be lent to SMEs, from what I understood you to be saying though, you would still be assessing each risk differently, so it may not necessarily change the need to have the house on the line because it's an individual credit decision. Did I understand you correctly?

**MR CARTER:** Yes. I think - we're starting to touch on an area which is challenging because we have multiple, potentially conflicting at some times, regulators and others in operation here, so as you've seen there's a significant political and public motivation to increase the level of protection for borrowers in a small business, and you know, my view, make that more consistent with consumer credit. If we - "responsible lending practices" means that if we - you know, we only looked at people's security on offer we would get ourselves into a lot of trouble with at least one regulator.

And so we need to make sure we're not blind to the underlying credit quality of the borrower. I think that small business credit will continue to open up for borrowers, and in our case we have spent a lot of time trying to understand historical risk selection and what makes - what are the characteristics of good borrowers? The last thing we ever want to do is realise someone's house or commercial property or any other security. For that matter it's - there are a whole host of reasons why we don't want to do that, and I think the availability of data, the technology which produces the cost to serve at scale as much as anything will enable that to evolve.

We've also seen new competition enter the market in some of the fintechs, and whilst they are tending to operate at the - not in the mainstream market, they are bringing technology and other solutions to customers and a customer experience there that forces the incumbents to act and respond.


© C'wlth of Australia

**MS ABRAMSON:** Thank you.

**MR CARTER:** Yes.

**DR KING:** One final one from me before - - -

**MR HARRIS:** No, you - and then you move on, yes.

**DR KING:** Yes. You mentioned the IRB model and the high level of sophisticated ability to have more nuanced understanding of the risks associated with, say, a residential mortgage. At the same time, regulation has moved to, in a sense, blunt that by putting floors on, increasing the floors and so on.

**MR CARTER:** Yes.

**DR KING:** How should we think about that what seems to be - you know, invest in a model that allows you to come up with - use more information and then regulation which says, "Well, whilst you've done all of that, now ignore that because there's a floor in there." How should we think about that?

**MR CARTER:** It goes back to my earlier point, I think. Risk weights can be used for a couple of purposes potentially, and maybe APRA's better placed to answer than me which purpose it's being used for, but in fairness people have asked APRA to try and level the playing field, and I think the use of floors, for example, is one way that is assisting the standardised banks to try and lift the average risk weighting on the mortgage portfolios of the IRB banks rather than perhaps where they were.

I think also to make it relatively less attractive to deploy so much capital into the residential housing market may be another objective in raising some floors, and then I'm sure there'll be another argument that says, "Actually, it's - prevention's better than cure, and because we're nervous that people haven't quite got this right, we're worried about a shock to the system and so we'll put capital in ahead of that potentially occurring: (a) to take some heat out; and (b) to make sure there's protection there."

**DR KING:** Do you see there's - I mean, you know, the extra capital has a cost, the cost has to be paid by someone - - -

**MR CARTER:** Yes.

**DR KING:** - - - do you see that as being ...(indistinct)... by the customers? I mean, are customers made worse off by these floors?

**MR CARTER:** I certainly think - there's only really - well, there's three stakeholders who are going to wear the cost of more capital: one is the shareholder in terms of return, and we have properly seen ROEs start to reduce in this country; two is the customer through paying high rates, and we've seen relatively higher rates on interest earning and investor


© C'wlth of Australia

lending, which as it turns out is where we've seen APRA target particularly with the changes, and the third is with your people, and that is we see less people working in banks going forward as people look to get cost out to try and offset the need for the return on the capital. So we are seeing that burden - if that's the right language - being shared as opposed to being directly worn by any one of those stakeholder groups.

**DR KING:** Just on mortgage brokers, just to change direction a bit - sorry I don't have the numbers off the top of my head - what's the sort of - the split in terms of finding home products through Suncorp in terms of brokers versus branches?

**MR CARTER:** Yes, we would say, you know, medium-term average is over 70, perhaps 75 per cent, and that is driven by a couple of factors: one is that we have the predominance of our physical presence is in Queensland, which is about 18 per cent of the mortgage market.

Two thirds of the mortgage market is in New South Wales and Victoria, and so if one wants to participate in that market for various reasons, i.e. to grow or to diversify risk, the mortgage broking channel offers us a relatively lower-cost entry into the market. We apply exactly the same lending standards to the assessment of that and our history suggests that the default risk on broker mortgages is roughly the same as mortgages we source ourselves, so we satisfied ourselves on that.

There is a marginally higher operating risk for information that we are given to assess on, we have to run the risk of a little bit - and maybe we need to test it a bit more so - but generally we have a very good relationship with the broker channel and we think it brings us more opportunity rather than less, particularly in places where we don't have a big physical presence.

**DR KING:** Okay. So, I mean, Suncorp as an institution that's growing, you face the decisions, do you open branches?

**MR CARTER:** Yes.

**DR KING:** Do you rely just on brokers in the particular area? Internally, how do you make that decision? How do you decide when - you know, is it the case that you tend to use brokers to build up a critical market mass in an area and then decide to open a branch, or are brokers just cheaper and a better way of running mortgages than branches or vice versa, are the branch - - -

**MR CARTER:** Yes. We don't sort of trade one off for the other in terms of that channel selection, I guess. We start with looking at what the customer's preferences are and what the opportunities are in market, so most of the activity in branches - well, certainly (a) is in decline and (b) has typically been on the deposit gathering and transaction banking side rather than home lending and small business lending by volume of the activity. By value of activity, obviously lending activity individually as a transaction's a more valuable


© C'wlth of Australia

activity to an organisation such as ours than a single transaction to put a hundred dollars in or take a hundred dollars out.

We see increasingly customers are time poor and have - you know, there is no stereotypical customer anymore who works Monday to Friday 9 to 4.30 and can take time off to come and see the bank during business hours, so we see a greater demand for virtual lending services, so people have an increasing propensity to do it on ...(indistinct)... on Skype with one of our staff sitting remotely. They like to do things over the phone from time to time, they like to visit brokers. Our ...(indistinct)... are starting to see - although not really in home loans too much yet, the emergence of people willing to do it online, and we think all of those channels are important.

So our decision in terms of broker or branch is really more a decision about a broader range of channels. Do we invest in a digital online origination capability ahead of a branch or further investment in broker? Broker is very scalable very quickly. We have controls in place to make sure we are comfortable with the brokers we're accrediting, but other than that we can achieve the scale quickly through their aggregated groups and others and potentially only write one line a month in a particular area, which would never sustain a physical point of presence but enables us to diversify our risk. More than half our new loans are written outside of Queensland, and that has been the case for several years now.

**MR CARTER:** Yes, okay. So there isn't any sort of internal model where building up a market share in a particular part of Sydney then opening a branch, or something like that?

**MR CARTER:** We have used that in the past. Having said that again, customer behaviour continues to evolve and change, and so if I went back a decade, certainly two decades that was exactly how you would choose it, you'd identify a market you thought was attractive for whatever reason and you would set up a physical presence there. Customers don't always require a physical presence, some do, some segments do, some don't.

**DR KING:** On the reverse side, does that mean you're closing branches?

**MR CARTER:** We have reduced a number of stores, yes, and again, that is driven by changes in customer behaviour as much as - that's the primary driver full stop, actually. And the format of stores is changing as well.

**DR KING:** Okay. Just one more from me before passing back: your heavy reliance on mortgage brokers outside Queensland, brokers who are often owned - or the aggregators are often owned by your competitors - - -

**MR CARTER:** Yes.

**DR KING:** - - - sounds like a potentially dangerous business model where you're reliant on your competitors and in many ways on their good will to have those brokers write your mortgages. Do you see a risk? A risk seems obvious to me, very obvious.


© C'wlth of Australia

**MR CARTER:** Yes, it is, it's very - look, it is very obvious, it is very - - -

**DR KING:** And what can you do about it?

**MR CARTER:** - - - very obvious to me, I think nine of the 10 largest broker groups we deal with have at least some level of shareholding from one of our competitors if not complete ownership. We support greater transparency of ownership, both ownership of the underlying group or aggregator and also more disclosure on the provider of white label mortgage products, so mortgage loans that are branded to the aggregator which may be being funded by the owner of the aggregator, and so we think that would be important.

We do support the broker channel. I think the vast, vast majority of brokers are honest, ethical people who are running nice businesses who really care about their clients. There is always a risk of a small number of people who need to be moved out of that industry and dealt with as in any industry. But we think a little bit more transparency around the ownership structures, more transparency on who is providing the underlying white-label mortgages enabling consumers to be in a position to make an informed decision before they make that choice is key.

**MR HARRIS:** But how does ethics make you as a broker choose wisely between two competing loans of the same price, the same term? Surely in that circumstance the default is going to be to the owner.

**MR CARTER:** I can't speak for the brokers. I would say the other considerations would go to the underwriting, so some banks have more appetite or less appetite for certain things, whether it is investor lending, two-bedroom units, one-bedroom units, five-bedroom houses, whatever people are looking to do in terms of managing their risks. So, you know, sometimes the same price, same term but different underwriting will lead to one choice being far more obvious to the broker and the client.

Where I worry in where we have that potential conflict is where soft-dollar incentives or even hard-dollar incentives are in play, so either things like the fee for being part of the group being waived on white label or manufacturer's-own loans, that is clearly an incentive where the remuneration to the broker will be higher as a result, the net remuneration will be higher, the gross may be the same, or where there are other things: points, prizes, trips, whatever, involved - that is a risk in that environment. Now, that said, again I would say we are very dependent on that market, we work closely with the aggregators, and the people we work with generally are pretty good at managing that conflict from what we've seen.

**MS ABRAMSON:** David, can I ask you a question on best interest? You'll see in the report that - - -

**MR CARTER:** Yes.

**MS ABRAMSON:** - - - was in the case of aggregators ...(indistinct)... best-interest duty, but wouldn't it be - if there was a best-interest duty, wouldn't that mean that your products


© C'wlth of Australia

could have more likelihood of being before the client because it is ...(indistinct)... because you might actually have the product that is in the best interest, and it's not not unsuitable, which is a different test. So I'm interested in your views on that.

**MR CARTER:** Yes. Again, a number of the aggregators we deal with have a very broad menu, for what of a better word, on the approved list, maybe up to 27-28 different providers' loans. We find - and I would say this, I've worked in life insurance, the wealth management and the banking world and we have a general business as well and commercial - - -

**MS ABRAMSON:** About to ask you about some of your ...(indistinct)... insurance.

**MR CARTER:** - - - and, generally, my experience with intermediaries and brokers and advisors is the things that really shape their thinking are around the reputation and integrity of the supplier, the consistency of the underwriting approach, so I know - I'm pretty confident I know that my client is going to get dealt with a certain way and I won't waste my time over there with that - you know, those - that criteria. And the third one then is the service and the relationship I have. Price and the product itself tend to be close behind that, four or five, and they tend to become the most important things that the first three are missing.

You may say that sounds a bit - like it's not really in the best interest, but I think it is because, you know, the broker is trying to give their client the best possible experience and outcome as a professional, they don't want the client's time wasted, they want to make sure that they're not going to be surprised that they can - they're not going to be treated poorly, and then that the product is going to work for what the client is trying to achieve. So I think that can work.

**MR HARRIS:** It sort of sounds though a bit like that total observation that our report came out with at the start, that there is competition in quality of service but not so much in price.

**MR CARTER:** I would say today in the trenches it's pretty intense, particularly in owner-occupied P&I mortgages, and from time to time investor interest-only, depending on who has got capacity in their caps. And what we have seen is volatility or variability in appetite, particularly from a couple of the very large players, and when they come into market in investor/interest-only, it's very obvious, and when they go out of market for a period on those two, it's very obvious. But new - you know, pricing on owner-occupied home loans is very competitive at the moment, and generally speaking we cannot afford to be far away from the lowest price in market with the broker channel in order to achieve the outcomes we're trying to achieve from a business point of view.

**MR HARRIS:** In a point in time I don't dispute that, and you reference what's happening with investor home loans, and again I don't think we dispute point in time; there is always some highly competitive price activity.


© C'wlth of Australia

The question is, from our perspective, much more a structural one: what motivates the likelihood of competition in the sustainable fashion over a reasonable period, and your description of broker-preferences does - when you listed your hierarchy, my first reaction was that's pretty much a description of not just broking activity but generically what we tend to find in the markets that we've been examining which is, as I said, quite a lot of competitive activity and attempts at product differentiation around quality of service and technology and factors like that but far less emphasis around price, and the best argument we can find for that appears to be the implication that just as the broker apparently is judging, consumers are less interested in price than they are in quality of service. But there's no evidence for that, there's just the proposition that that's the way it goes in this market.

**MR CARTER:** I don't know what the basis for customers not chasing the last three or four basis points is, but I would agree that, in my experience, customers want - or consumers/customers want to be dealt with fairly. Their view on what is fair is not just shaped purely by price, and I think brokers are no different, and I think there are many industries that are the same, and, you know, to use an analogy that's got nothing to do with anything that's politically sensitive at the moment, a Toyota and a BMW both have four wheels and engines and seats, and they're probably both pretty safe motor vehicles, but some people are prepared to pay - - -

**MS ABRAMSON:** You made me think of the airbags thing.

**MR CARTER:** - - - two or three times - some people pay two or three times the price for a BMW over a Toyota, now that's their perception of value, whatever reason is motivating that behaviour I don't know, but that is a perception. It doesn't mean that one car is three times better than the other necessarily.

**MR HARRIS:** Yes. You mentioned this three-notch difference which comes up quite a lot in terms of a rating agency's differentiation. It's hard to imagine though a rating agency not looking at the scale and simply not offering an advantage because of that, in other words there is surely a limit to how far regulators are able to encourage - ratings agencies have a different view of "too big to fail". I mean, there is a logic which says - and it has been put to us by other participants in the course of the inquiry that says, "But surely the government or, you know - fill in the blank, whoever it is — the regulator is going to allow — fill in the blank - this particular regionally important financial institution to fail."

And therefore, you know - I guess the thing is, "We're all too big to fail therefore we should all have the same ratings coverage," but from a ratings agency perspective, surely they have every incentive to find a differentiation factor otherwise who wants advice from ratings agencies if every Australian bank is treated, you know, as too big to fail then there's no real business case for a ratings agency to be paid to do their job either. So surely they're going to find this, and it's a bit of a fool's errand for public policy to keep trying to alter that differentiation. Or am I being too harsh again?


© C'wlth of Australia

**MR CARTER:** No, we accept that there should be a reward for scale and quality, and we in fact received that ourselves. We issue at A+ even though our standalone bank rating is lower, and we issue at A+ because of the strength of the group, which is a bigger group housing a small bank. And that undoubtedly gives us access to markets, particularly offshore, that some of my regional peers have much less access to. It doesn't give me the same price though as the majors who without the too big to fail guarantee would be at a similar rating or lower.

Now, they probably would still get a better price because they issue more frequently, their issuances are far more liquid in the secondary market, so people can trade in and out, and people understand them more than they understand us, so that is the advantage they have and we accept that. We think, as others have suggested, either the whole system is too big to fail, and I think for the depositor in certain ...(indistinct)... bank here, they don't want to have the stress of thinking that their bank isn't going to survive and, you know, depositors haven't lost money in the Australian banking system for well over a century so - in the regulated sector, so I think that is a very strong track record and I doubt, if push came to shove, that would be allowed to happen.

And I note your comments that, you know, increasing the cost of funding to major banks by moving too big to fail wouldn't be good for the customer, normalising or equalising that would presumably be better. There is a second vehicle that is available, and that is through the covered bonds facility, so APRA and the RBA had provision for a covered bond which allows people to issue with the backing of the sovereign. We use it, not everyone has that vehicle in place. The majors have just a similar access to us, even though they already have the ability to access all other funding markets with too big to fail sitting behind them.

One could rebalance the allocation of the same amount of covered bond capacity in the system and give some more capacity to the smaller banks and that would enable some of them to access some of the advantages of the sovereign rating whilst recognising that the majors have more capacity, so I think too big to fail is not just about the price one pays, it is also about the accessibility. It's taken us five to six years to achieve the current pricing we have in the US markets and with Asian and indeed domestic investors; now, part of that will be idiosyncratic to us, part of that is the price of building a relationship and becoming an issuer who can then fill in all of the terms to enable the pricing curve to be accurately established by the market.

Too big to fail gives one a fairly quick - a much shorter path to the same curve which has an advantage. We are now getting pricing that if we had three years ago the funding that we took our for five years three years ago would have a better impact on our funding cost as at today. So they're the advantages I see. In fairness to our regulators, I don't think they committed the too big to fail idea to the ratings agencies, I think the ratings agencies chose to do that and - - -

**MR HARRIS:** That was really what I was trying to suggest.

**MR CARTER:** Yes, yes.


© C'wlth of Australia

**MR HARRIS:** In other words it's inevitable that they're going to find this differentiation for themselves despite any effort by regulators or another party to dispute it.

**MR CARTER:** I agree there'll always be a difference, it's just whether the quantum of the difference is reasonable or not. As I say, we have no concerns that we would pay a premium to a CBA or a Westpac for the same funding for the same term issued on the same day; the question is: what is a fair premium when you're issuing at A+?

**MS ABRAMSON:** Can I ask - - -

**MR HARRIS:** Yes, go.

**MS ABRAMSON:** Could I ask you, David, a bit about your insurance business? We've got a couple of recommendations that actually go to that. Maybe around transparency and prices. I'm happy if you want to respond in writing to that, but if you had something to say today that would be quite helpful.

**MR CARTER:** I may just have a general comment and then I would like the opportunity to respond in writing. It's not somewhere where I spend a lot of my time, to be honest.

**MS ABRAMSON:** No, I appreciate that.

**MR CARTER:** But we support greater transparency and consumers being able to make an informed choice, an informed decision about what they're doing, so the question then becomes: how do you achieve that in a way that is meaningful for customers that they can actually take advantage of that transparency? One of the challenges we have in this country, whether it's insurance, banking, superannuation, whatever, is financial literacy levels are not as great as would be ideal, and so we need to make things simple and easy for people to understand then we need to encourage them to use the information, but we can provide a more fuller response in writing too.

**MS ABRAMSON:** Yes, because one of the issues that we did highlight in our report is - and you're a substantial underwriter - is there's a lot of brands but actually there's the one underwriter. So given that you're in the industry and that's part of your business model it would be very useful for us to have a considered approach.

**MR CARTER:** Okay, and we'll pick up that. I might just observe. Each of our brands potentially underwrites in different ways, I'll give you very simple example: I drive an old Holden. Most of our brands will not give me the cover for that car to the level - the value of the vehicle, not that it's particularly valuable, but Shannons, which is a specialist in certain cars will enable me to. I have to pay the price but that's fine because I have the cover so - but we can - - -

**MS ABRAMSON:** ...(indistinct)... helpful, thank you.


© C'wlth of Australia

**MR HARRIS:** Since we're on insurance - although it does bridge the two - then there's mortgage insurance.

**MR CARTER:** Yes.

**MR HARRIS:** So a number of parties have told us, somewhat surprisingly given there's relatively few providers of lender's mortgage insurance, but a number of loan providers have said that they - appear to say they don't go out to market to retender this option very often. It seems pretty unusual. It would be a logical thing to do: it's quite a significant price for the borrower who is required to take out that insurance, yet almost on their behalf, almost again acting in the customer's best interest you would expect that some part of the financial institution would say, "You know, we should retender this business every now and then, find the best price."

**MR CARTER:** Yes.

**MR HARRIS:** Does Suncorp do that or - - -

**MR CARTER:** Yes, we do look at each expiry. The thing with LMI is you need to look for a cycle. We've had a very good housing cycle, at some point that will change, and so the contracts tend to be a bit longer because the insurer's going to want to see a little bit more than just one or two years of the cycle. We find that lender's mortgage - well, like everyone we use it ...(indistinct)... there are basically two models, there is the, you know, lender's mortgage insurance issued by a lender's mortgage insurer and then there are a couple of the large banks who are running their own captive kind of model and not having to run necessarily insurance licences fully, shall we say, as others.

So we certainly look at that because the price to the borrower of the LMI is fundamental to being able to compete for that loan. LMI we find is really important for the first home buyer market in particular in this country, so again, if I look at the risk weights, if you look to lend more than 80 per cent of the value which particularly in Melbourne and Sydney but also Brisbane also Perth also Adelaide - is typically a first home buyer who doesn't have a 20 per cent deposit. So if you're going to lend in that market without LMI, the risk weights go up materially and therefore the price would need to go up materially. LMI does support a better price for the duration of the loan for the customer.

But there are two substantive providers in the traditional market. There are overseas reinsurers who are actively touting new business models for LMI and we would - we, like others, I'm sure, evaluate those opportunities as they come up. When our contracts expire with our current provider coming into that period we then look to evaluate whether it's worth considering change. We consider the experience our customers have had, the way the insurer looks at the claims, and have we had, you know, big arguments about whether claims will be paid or not - in our case no. And then the systems and other things: what is the work involved ...(indistinct)... because the LMI process is heavily embedded in our systems and our lending - loan-assessment origination process.


© C'wlth of Australia

And so it's sort of a six to 12-month activity to change insurers, so it's not simple to change, and therefore we tend to start with an initial evaluation at least 12 months out from the expiry date.

**MR HARRIS:** You're just going back to the broad proposition again that you see in the finance system generally quite a lot of emphasis on competition and quality of service, and you mentioned performance of the insurer in paying you as a financial institution, but the consumer's actually paying that cost.

**MR CARTER:** Yes.

**MR HARRIS:** And so again, appears to be less emphasis here on the price incurred by the consumer and more emphasis on the quality of service to the financial institution.

**MR CARTER:** I think that's - no, I don't feel that's fair. The price to the consumer of the loan itself would be materially higher without the LMI being there, so the consumer would pay for that throughout the loan. Secondly, LMI enables - it's true that LMI does cover the - any loss on default to the bank, but it also enables the risk characteristics of that market which is inherently a little bit more risky for first home buyers in particular, high LVRs as well. It does enable the risk to be more acceptable, so it causes us to want to compete in that market which must be good for the consumers in that market.

One of the areas I would highlight though that is a challenge is first home buyers are often also first home builders, and the current macroprudential focus on interest-only picks up construction loans as a part of interest-only because for the first part of their duration as the loan - as the house is being built, they are interest-only in nature which is a logical thing to do. Customers are typically paying rent whilst they build the house, then they move in, then they go to ...(indistinct)....

But we have to include that in our interest-only cap, that lending. So again at the margin it makes that relatively less attractive, that market. So an unintended consequence, no doubt, but, you know, one that we would have preferred not to have been included in the interest-only cap to enable us to fully support that market.

**MR HARRIS:** Okay. Just one last question on LMI. So we asked at least one of the major banks last week who I think didn't have any information. We'll probably pursue this directly. So what's the performance of LMI generally in your experience? I mean, ASIC as you undoubtedly know has reviewed a number of insurance products and found that some of them are, you know, pretty disgraceful in terms of the price that they charge and the actual claims performed - - -

**MR CARTER:** Yes.

**MR HARRIS:** - - - against them; is LMI in that category?


© C'wlth of Australia

**MR CARTER:** Again, you'd need - and we haven't had a bad down cycle across the country in housing for some time, but I think one needs to look through the cycle. So if you looked in recent years, the claims payout ratios have been reasonably low, reflective of a very strong housing market.

However, if one looked in Western Australia - and we've seen one of the LMI providers comment quite specifically on Western Australia - the claims payout ratio has been relatively higher. And if you looked at parts of regional Queensland, particularly in the mining towns, whilst we ourselves haven't suffered a lot of defaults in that market, we chose not to be too aggressive in gaining share there. We have seen elevated payout ratios, but again, against a backdrop of a very benign housing cycle over the last quite a few years. Interest rates go up, unemployment levels go up, we would see a different cycle for the LMI providers.

**MR HARRIS:** Well, as I said, we might come and ask for some information.

**MR CARTER:** Yes, we'd be happy to supply that information.

**DR KING:** Just one more on LMI before we finish up: so you've said the providers - the external providers really want to do a contract long enough to go across the cycle, are we talking four, five, six years? How - - -

**MR CARTER:** Yes, I think typically the economics would work at about five and then potentially extending for shorter durations, maybe two years at a time.

**DR KING:** Okay.

**MR CARTER:** There is a ...(indistinct)... cost of - - -

**DR KING:** Setting it up.

**MR CARTER:** - - - setting it up, getting it up and running, changing underwriting, all that sort of stuff.

**DR KING:** Okay. So during that period of - if I came to Suncorp for a home loan and I had only, let's say, 90 per cent - 90 per cent LVR, so only 10 per cent deposit, the LMI coverage that I would need, that would simply be in a sense a "take it or leave it" offer for me the, the customer. I don't have a choice of saying, "No (indistinct words)."

**MR CARTER:** It's not portable and there isn't a choice, no. We use a model with a single provider. I'm aware a couple of major banks use an in-house captive as well as an external provider, although I don't know whether that is for customer choice purposes or lender choice as to which risks they keep themselves and which risks they move outside, and that probably reflects the fee the customer is charged for the insurance.


© C'wlth of Australia

**DR KING:** Okay. I mean, so when you're tendering - I mean, normally if you - you know, if you're a large corporate and you're tendering for a service provider, which is what this is, there'd be some sort of volume discounts built in or, you know, there'd be various - you know, "If you meet this level you get this discount, if you meet" - do the contracts have that sort of volume discount or feedback, and if so how does it work?

**MR CARTER:** Yes, again, the contracts will be varying over time. Things like discounts and rebates modernise, I guess, in terms of people's perception of them, but typically there is an agreed price that would be able to be passed through to consumers, so a discount from the rack rate, if you like, which would enable the price to be more competitive for the customer. There is in return for exclusivity often support to invest in the origination infrastructure, for example we've used support in the past to invest in things like fraud controls and fraud detection in the origination process, and then there is typically a sharing in some form of the benefit of good underwriting, i.e. lower claims, and that enables, you know, the lender - that's to, I guess, encourage the lender not to just turn a blind eye and accept everything, even if the risk is not good. Now, responsible lending encourages you to do your lending the right way anyway, but they're the kinds - tend to be the features.

**MR HARRIS:** Okay. Thank you very much for your time and for Suncorp's participation both back at the roundtable and your submission the other day, so thank you very much and we may be in touch on further days.

**MR CARTER:** Thank you. Happy to help. Thank you very much.

**MR HARRIS:** Okay, Nick Gruen, come on down. Nick, can you introduce yourself for the record.

**MR GRUEN**: I can.

**MR HARRIS:** Once you get the glass of water. Get the glass of water.

**MR GRUEN**: Yes, I'll get a glass of water and I'll get - try and get myself ready.

**MR HARRIS:** All this goes over the microphone too - - -

**MR GRUEN**: Yes, I know, very good work, isn't it?

**MR HARRIS:** Pour your glass of water before we're talking, otherwise you're listening on the thing.

**MR GRUEN**: It's good quality water.

**MR HARRIS:** Yes. Now these ones, there's no inaudible bits at all with these kind of microphones.

**MR GRUEN**: Okay, well do you want me to go?


© C'wlth of Australia

**MR HARRIS:** Introduce yourself for the record.

**MR GRUEN**: Yes, for the record, Nicholas Gruen is my name. I founded a company called Lateral Economics on April Fools' Day in the year 2000, along with a mortgage broker that I might not talk much about that, and I presented a submission to the Commission which, in its wisdom, it roughly ignored and I'm here in a spirit of curiosity to understand how worthless it really was. So, I guess - - -

**MR HARRIS:** You know us, Nick, we never ignore anything. We may not have referenced it, but you know we never ignore it.

**MR GRUEN**: Well, by ignore it, I'm not hungry for the column inches, I'm talking about in your thinking.

**MR HARRIS:** Yes.

**MR GRUEN**: It doesn't appear, and nor does any of the possible directions that it might take, that it might have taken you. So that was really what I was trying to - that was the main thing I wanted to talk to you about. But as I tried to master what is a very large document, I came across some things which I thought might be worth discussing a bit later on.

**MR HARRIS:** Sure. So I've got a bunch of questions which came up from my original reading of your submission, your couple of online articles and most of the Bank of England paper that you referenced, and most of the questions that I've got are relating to what I consider to be practical implementation kind of activity which goes to the question of how could this plausibly work without being more than I think the destabilising influence or the disruption that you might have envisaged.

But what I thought I first might do, rather than jump into that kind of questioning is give you the opportunity to talk about how you envisaged the proposition that you had might work, and particularly what aspect of competition in banking you're targeting with it.

**MR GRUEN**: Okay. Well, I guess it might be - that may be one way into that would be to discuss what I suggested was a more general proposition about competitive neutrality, because it seems to me that there are some areas - and this was the idea that the Commission is a great champion of competitive neutrality, if you like, as a shield to business and not a sword. Then the question becomes whether one might use it as a sword, not a shield.

It's quite obvious that what I've suggested in banking shouldn't simply be implemented on the grounds of competitive neutrality. As you say, there are a million practical, structural things that would be a very big change. As I called my paper that I published in the UK, it was a modest proposal for radical reform. But there is also the


© C'wlth of Australia

wealth management side where it's not - whether it's a modest proposal for more competition.

Now, that is not technically relevant to the way in which you've - the way in which you've divided up the division of labour between two inquiries here, because you've got super as a different inquiry. But as far as I understand the report, you are looking at wealth management.

**MR HARRIS:** Yes, we were going - - -

**MR GRUEN**: So, it is quite easy to say that if the government is producing wealth management services, it is a worthwhile question to ask, "Could this be cost-effectively added to the stock of competition in wealth management," and it was that that I was inviting you to deliberate on. I think, though it's such a big report, I can't - I haven't read every page - but having done word searches and read where I thought these issues would be, I would have thought that was worthy of some discussion.

So that's, in a sense, in the nature of some kind of introductory comment, so I'd be interested in, you know, what your - what you make of the idea of competitive neutrality as a sword rather than a shield.

**MR HARRIS:** So, I don't think in doing our policy design response we necessarily choose responses on that basis. We ask ourselves originally the question, "Is there evidence that market power is being used for advantage in this market and, if so, what are offsets to that market power?" and that's pretty much the way we've tried to structure the report.

While there is evidence of market power, a solution which is one that, as I understand your proposition, says we could use public funding to create an alternative source of competition in this market, it does seem to be reasonably radical, and I think from our perspective, therefore, it's not a question of whether - how it's sort of necessarily classified, it's more a question of saying, "Does the solution match the scope of the problem?"

**MR GRUEN**: Well, yes. So, I see the things that - I don't - I'm not trying to use public funding to do anything. It's possible that some public funding comes along, but it's very minor. What I'm talking about is existing assets, existing institutions. So, we - the Commonwealth - and so, the Commonwealth provides wealth management services to its employees. That's called superannuation. You are looking puzzled.

So, it's not a matter of saying, "Oh well, we've got a problem, make the government fix it," it's just thinking of these assets that governments own as a natural and normal part of the market, that we make sure they're not competing on unfair terms, and then they're a participant in the market. This is - you know, I just don't feel - I can accept that what I proposed in banking is radical, like, that was in the title of what I proposed. I don't accept that saying that if hundreds of thousands of public servants can access Commonwealth wealth management services that it is particularly radical to build an interface which allows anyone to do that.


© C'wlth of Australia

**MR HARRIS:** No, no, but you are proposing - to get it clear then, so that we're not just tap dancing around the edges, you are proposing a proposition under which a sovereign entity takes deposits and enters the loan market and using those deposits. So, my version of them funding - - -

**MR GRUEN**: Well, just hang on, we're talking about different things.

**MR HARRIS:** Correct me in substance on that, so - because that's the way we read your paper and your online articles.

**MR GRUEN**: I'm talking about Commonwealth superannuation at the moment. So, the submission I gave you talked about competitive neutrality. I fully accept that the banking proposal I put - certainly just me calling it competitive neutrality doesn't go half - doesn't go a quarter, doesn't go a tenth of the way of considering the implications of it.

So, just to consider competitive neutrality, I wanted to - I suggested that a way into that, to talk about simply that principle, was to talk about Commonwealth provision of wealth management services. Okay, that's what I proposed briefly to discuss, because I want to explore the question of competitive neutrality without all the extraneous stuff, which we hopefully will get on to.

**MR HARRIS:** Okay. But the fact that the Commonwealth has accorded itself as an employment - a factor of its employment, the opportunity to play in wealth management via superannuation doesn't argue, does it, for it to do the same in banking?

**MR GRUEN**: No.

**MR HARRIS:** No. So, what we have is - we have a fact of life and - - -

**MR GRUEN**: So, I'm talking about the Commonwealth - I'm trying to focus on what the Commonwealth does with this asset, which is that it set itself up to manage a large amount of Commonwealth employees' money. That's what I'm trying to focus on, so that we can have a discussion about competitive neutrality, and then we can talk about banking. Now, your report talks about wealth management.

**MR HARRIS:** It talks about wealth management not in the sense of managing an asset, but in the sense of saying, "Is it a source of competition for a provider in the banking system?" That's where we do wealth management. Otherwise, in superannuation, to the extent that the Commonwealth's activity comes up in superannuation reports, it will, I guess, feature at the margin. But, you know, again in the superannuation reviews, we were asked a different kind of question. We were asked, "What are the efficiency characteristics and can you better apply them, including through competitive solutions through default superannuation?"


© C'wlth of Australia

So, there were a series of questions that are asked of us in that terms of reference. But for the purpose of competition in the banking and finance system, the fact that the Commonwealth - as I said, it accords itself the ability to play in wealth management doesn't demonstrate one way or the other whether it should accord itself that privilege to play in the provision of other financial services. I mean, it could, but the threshold question for us is, what's the competition issue that such an intervention is meant to be solving?

**MR GRUEN**: Yes. Well that, to me, seems like a very ideological way to put the question. The question is - for me, there are assets and we want as much competition as we can have. We don't say - you know, we could say, "Should we let" - we could ask any number of deregulatory questions, but we don't say - we don't - it doesn't seem to me that we say - I mean, for instance, these arguments about foreign investment, people say, "Do we have a problem with foreign investment?" - which seems like a very odd way to ask the question.

You've got a bunch of assets, and a market is a bunch of assets which are, if you like, firms in the private sector or the public sector, and they're competing, they're participating in that market. It seems very odd to simply say, "Oh well, we won't - we won't - we've built this asset" - and here I'm talking about the Future Fund, and so on, or Commonwealth wealth management assets. "We've built this asset, we built it for that reason, therefore we won't - even though it would be a very minor cost to allow it to participate in that market, we won't do it, because we will only let - do it if we're - if we can see a problem." That seems to be a strange way to look at it.

**MR HARRIS:** No, but I think as I said in my opening comments, I wasn't looking at it that way. My questions with your model are entirely relating to the ones that would occur were it to be enabled, were it to actually enter markets.

**MR GRUEN**: Yes.

**MR HARRIS:** And I would like to get onto them in due course, but - because I did read in some of your public comments this frustration that you have about what I would call a philosophical difference. So, to the extent we're putting labels, yes, we're ideological and - well, you're philosophical. But the bottom line is, we're not going to get anywhere with that kind of activity between us here today.

I'm actually trying to work out why you prefer to see competition come via this mechanism. I think I heard the answer, something that you just said, you suggested that we should have as much competition as we can. In other words, any participant, including a sovereign-backed participant, is a legitimate participant in any market.

**MR GRUEN**: So long as there is - that's right, so long as there are - so long as there is competitive neutrality. So, I don't want to - I would support the Commission's view that you don't want to have government-backed organisations taking advantage of artificial benefits that they have. For instance, different tax arrangements, and so on. If they do have different tax arrangements, then you try and make allowances for those, okay.


© C'wlth of Australia

**MR HARRIS:** So, in the case of the banking system, which so depends on confidence, the absolute safety of a Commonwealth-supported entity - we can debate support, but the bottom line is an entity that is perceived by the public as that, will in some circumstances be the primary place to go in a flight to safety.

And we've seen that in a global financial crisis where regardless of what the price was, people have said, "I want" - I've said, a large investor said, "I want other safety, and we are happy to take negative interest rates as a consequence." So how would you deal with that in a competitive neutrality sense? The participant is absolutely the safest place to go.

**MR GRUEN:** I would deal with it in the same way we do with banknotes, or we did in 1844, which is the market will choose who is better - who is safer, and the central bank is a safer provider of credit. Therefore, when it - when the Bank of England becomes the dominant issuer of banknotes, that's the market speaking.

So I don't regard the fact that the Commonwealth is the issuer of currency as a - it's not like it doesn't have to pay tax and the others do, it's actually - you know, this is why we don't have tax farming and things like that. There are things that the Commonwealth does that it has a cost advantage doing.

**MR HARRIS:** So, just on competitive neutrality because that was your preferred arguing base, just on that - so, the notes isn't really a question, because we don't have multiple parties. We once did. Historically, we had many, many parties promising to pay you.

**MR GRUEN**: It's the same, it's analogous situation.

**MR HARRIS:** But we don't have it anymore.

**MR GRUEN**: Yes.

**MR HARRIS:** We have one only, whereas we have many parties in the financial system at the moment. So, were the Commonwealth to turn up and become a player in the banking system, and were they be a flight to safety, even though deposits were guaranteed as well by the Commonwealth in some other parts of the system, and we've just had some of the smaller players here talking about whether too big to fail has been a perception problem for them in the marketplace and, clearly, it's a perception problem that translates to actual cost to them in terms of rating agencies' use.

You're going to have - if you have this flight to safety, if that event occurs and you have a Commonwealth participant, it's going to be the preferred place to put your deposits for some people. And the smaller parts of the financial system at least will eventually suffer.

**MR GRUEN**: And everybody - - -


© C'wlth of Australia

**MR HARRIS:** That's a competitive - I'm just going on a competitive neutrality preferred argument basis. That's a competitive neutrality problem that I cannot see anybody offsetting.

**MR GRUEN**: It's not a problem.

**MR HARRIS:** Because it's inherent - - -

**MR GRUEN**: It's not a problem.

**MR HARRIS:** Well, it's not a problem to see a flight to safety so that the smaller financial institutions in our current system, if they lose their deposit base to the Commonwealth entity that you suggest be in the marketplace, that's not a problem.

**MR GRUEN**: Of course, it's not a problem, it's a - it's a flight to safety. The market wants safety and these ones can't supply it.

**MR HARRIS:** But in a disruption sense, you're not bothered by that?

**MR GRUEN**: I don't know what you mean by a disruption sense. We guaranteed the banking system. Everybody had a Commonwealth guarantee in 2008.

**MR HARRIS:** Up to a potential value of dollars.

**MR GRUEN**: Yes.

**MR HARRIS:** Not an absolute. Indeed, the regulators have tried to go on the record subsequently as saying it's not as substantial as people might have believed.

**MR GRUEN**: I know, they're frequently on the record saying that - - -

**MR HARRIS:** So, I think there's more evidence - - -

**MR GRUEN**: - - - including before 2008.

**MR HARRIS:** I think there's more evidence on my side than on yours to say, and that's why I say, you will see institutions potentially shut their doors. And that does seem to me to be an inherent problem with creating the institutions that you want to create in the first place. That is, it will add to instability in certain circumstances.

**MR GRUEN**: Well, I guess, yes, the idea that this is instability, when what it's doing is, it's doing what we did anyway, which is to guarantee the banks. So, yes, that's the whole problem and we're all trying to pretend that it's not the problem. I mean, if we're going through - if we're going through economic circumstances where at some stage people might want safer - a safer place to put their money, then - and suddenly that then becomes not a matter of meeting that need, now we're talking about competitive neutrality. Now we're


© C'wlth of Australia

saying, "Look, the smart money has long since departed, but we want the little people to keep their money in a bank that's going down."

**MR HARRIS:** I'm just simply saying it's a characteristic of the entity that you're proposing to be created that can't be dealt with under competitive neutrality. You're for arguing a basis for doing it. I'm simply saying you can't contract it away or eliminate it and, therefore, it it is one reason why you can't be competitive and neutral were we to create this.

I would like to go on and add to that the loan activity, because again, if I read your public comments on this correctly, not so much in the submission you put to us, but in the things you said to it publicly about the proposition, you're talking about low-risk loans being the primary target for this new Commonwealth Bank entity.

**MR GRUEN**: It's the Reserve Bank.

**MR HARRIS:** Yes, well - - -

**MR GRUEN**: It's not new, it's an existing asset.

**MR HARRIS:** Okay, but - - -

**MR GRUEN**: And all of the banks bank with the bank.

**MR HARRIS:** Hang on - - -

**MR GRUEN**: They bank with the people's bank.

**MR HARRIS:** Yes, but I'm sort of taking a fact that you did state in relation to your model, and suggesting that - - -

**MR GRUEN**: Well, I didn't say that in the existing model that there was another entity; it's the Reserve Bank of Australia.

**MR HARRIS:** No, I'm trying to be - it doesn't have to be the Reserve Bank, it could be any kind of entity that has similar characteristics.

**MR GRUEN**: Well, then it wouldn't be my proposal.

**MR HARRIS:** Okay.

**MR GRUEN**: So, why don't we talk about what I want to talk about?

**MR HARRIS:** All right, we'll talk about the Reserve Bank. If the Reserve Bank is a borrower of low-risk loans then - - -


© C'wlth of Australia

**MR GRUEN**: A lender of low-risk loans.

**MR HARRIS:** Or a taker of them, so they're out of the marketplace for other participants. So, they've lost some low-risk loan activity.

**MR GRUEN**: Correct.

**MR HARRIS:** Which means other participants in the marketplace are, by definition, higher risk than they were.

**MR GRUEN**: Correct.

**MR HARRIS:** So, again, in this circumstance of instability, we're leaving a higher risk with other parties, and we're happy to do that.

**MR GRUEN**: M'mm.

**MR HARRIS:** You don't think that's a disruption within - - -

**MR GRUEN**: Of course it's a disruption; I thought you people were into disruption.

**MR HARRIS:** Is it a - well, let's not go - I mean, is it a pro-competitive disruption?

**MR GRUEN**: Well, it's - - -

**MR HARRIS:** Is it worth having as the participants disappear from the marketplace because they've been induced to only remain in high-risk loans?

**MR GRUEN**: Well, these - I mean, this is the point. I mean, I can provide you with the analogy of banknotes. There were high-cost participants in the market for banknotes, and there were - was a low-cost participant in the market for banknotes. That was the Bank of England, the central bank. So, then the market works out that nobody wants these high-cost notes.

So, if you are - so what - we've got a market at the moment where low cost - sorry, low-risk loans are priced at the same from 80 per cent down to - down to zero loan-to-valuation ratio. This is not consistent with a competitive market. The private sector, for reasons that I've outlined, is far more - it incurs all kinds of costs in managing these risks that the central bank doesn't manage, the central bank doesn't bear.

So, what we've got is we've got a situation where these banks get access to that, bank with much greater efficiency, the little people don't. So, there's competitive non-neutrality. And so, I guess, yes, you want the market, like we have with banknotes, you want the market to reflect resource costs, which is not what we're doing.


© C'wlth of Australia

**MR HARRIS:** I guess my - just before you go, Stephen, my overall summary though, Nick, is, the problem that I'm identifying here is one where you are skewing the marketplace in a fashion that cannot be competitively neutral with those things.

**MR GRUEN**: As with banknotes.

**MR HARRIS:** I just wanted to be clear, that's the problem.

**MR GRUEN**: Yes, that's true, that's true.

**MR HARRIS:** And you're just accepting that that's - - -

**MR GRUEN**: I'm saying that the Commonwealth is a vastly lower cost provider of low-risk loans.

**MR HARRIS:** And you are happy with that cost on one side, because you think the advantage is greater on the other side, the benefit.

**MR GRUEN**: Well, sorry, I was just talking about benefit, not cost. You're talking about a cost of the shake-out of higher-risk lending. You're talking about that as a cost, and you're talking about it in terms of instability, rather than - rather than a market adjusting with plenty of disruption, I completely accept. The other thing is, let's - if we want to look it in that way, that there are benefits and then there are costs, I've had senior public servants say to me that they were looking forward to the Productivity Commission exploring that and giving them some guidance on it, because they're interested in the question.

**MR HARRIS:** Many people - - -

**MR GRUEN**: I would be interested. I think it would be good if the Productivity Commission, rather than say, "We're a bit worried because there's an instability problem," actually provided us with some analysis, like the Bank of England does.

**MR HARRIS:** Sorry, I think your dismissal of our worry as being not contributory to analysis is a bit poor. That is part of an analysis for us to consider - - -

**MR GRUEN**: Well, it's not on the paper, it's here. This is the first I've heard of it.

**MR HARRIS:** Well, that's why you came along today so you can hear it. If everything - - -

**MR GRUEN**: What about the public servants who have made comments to me that they thought that the Productivity Commission - they were looking forward to the Productivity Commission's analysis of the question.

**MR HARRIS:** Nick, many people have expectations of us, and the fact that we disappoint them is hardly a surprise to you or to me. Every one of our inquiries is meant to cover


© C'wlth of Australia

everything we possibly can, but, of course, can't do that. In any event, I was trying to explain to you how, on a competitive neutrality basis, there are some factors that, in our view, would be quite serious - - -

**MR GRUEN**: They are serious, that's why it would be good to talk about it.

**MR HARRIS:** They're not small - - -

**MR GRUEN**: Yes, they're not small, they're not. Might be worth a sustained discussion.

**DR KING:** I was going to follow up on your point, Peter. So, I think it was 60 LVR - 60 per cent LVR was - - -

**MR GRUEN**: That was a for instance.

**DR KING:** Yes, so let's take that for instance, let's say that was put in place - so, in this new body.

**MR GRUEN**: So, what, in - - -

**DR KING:** In the RBA.

**MR GRUEN**: What was it? Was it 1910?

**DR KING:** I was going to say RBA.

**MR GRUEN**: No, it wasn't, it was 1959, sorry.

**DR KING:** Where do you see - so, I'm taking your money example. Do you see people who have - can't meet those standards, so, an LVR - say, a first home buyer with an LVR of 90, so they can't get the Reserve Bank's product by - - -

**MR GRUEN**: Well, they can. They can get the Reserve Bank's product on the first 60 if they can find the next 30.

**DR KING:** Okay, so they can't get the Reserve Bank's product to fund their purchase.

**MR GRUEN**: Correct.

**DR KING:** So, coming back to Peter's point, doesn't that just mean that you're just exacerbating a problem that's been pointed out by numerous economists in the current system which is that a too big to fail type system with a residual around the edge just pushes - it's just an adverse selection problem. You end up with all the problem loans going out to, in your case, everyone but the Reserve Bank and - - -

**MR GRUEN**: Well, any - - -


© C'wlth of Australia

**DR KING:** I mean, what possible way does that make a system - a banking system that is either economically stable, or politically stable - - -

**MR GRUEN**: Well, you're a fine bunch of socialists, I think, you want this to be covered collectively. I mean, if you're taking out a risky loan - - -

**DR KING:** No, I'm asking a question.

**MR GRUEN**: I'm trying to answer it. You're taking out a risky loan, aren't you trying to - if you're taking out a risky loan, shouldn't that be priced in? Shouldn't these be - isn't that the skill that we want from private banking, people who can make decisions about what kinds of loans they want?

**DR KING:** So, you're quite happy with simply saying the government body takes all the safe product, with the risky product you take outside?

**MR GRUEN**: Anyone in the market who wants to - anyone in the market who wants to compete for the safe product takes the safe product.

**DR KING:** Except the government body?

**MR GRUEN**: No, the market.

**DR KING:** Well, you've said the government body doesn't compete that, you've said 60 per cent LVR for the government body.

**MR GRUEN**: That's right, correct. Sorry, I was talking about the 60 per cent: everyone, including the government body, is free to compete with that - for that, correct.

**DR KING:** And on your basis, you believe the government body will probably get a monopoly on that, given your - - -

**MR GRUEN**: But it will have a very large market share, no doubt about it, correct.

**DR KING:** Given your money analogy, you'll expect a monopoly.

**MR GRUEN**: Yes.

**DR KING:** And for the rest of the high-risk loans, you expect these to work out - - -

**MR GRUEN**: No.

**DR KING:** So campaigns here, and so on - - -


© C'wlth of Australia

**MR GRUEN**: No, I mean - well, they - if - it's quite possible that - in fact, you would expect that this would bring down the average loan-to-valuation ratio of new loans, that banks would not - if you get - if part of the mortgage that you've got is from 60 per cent upwards and previously you've been funding 90 per cent loans, you don't fund 90 per cent loans, you fund 85 per cent loans or 80 per cent loans, and you do it probably at a higher price, and then you're starting to see markets price risk.

**DR KING:** Okay, so this would - so, your new homebuyer would be massively adversely affected, for example, by this, because they would be left out. They're the adverse selection group, they're the high-risk group that you're talking out there in the marketplace and saying, well - on what you just said, you don't expect them to get a loan, you don't expect the 90 LVRs to even get a loan.

**MR GRUEN**: No, no, I - it's true that you would - the - one would expect the market to be less generous at the higher level because greater risk has been taken on, that's absolutely true.

**DR KING:** Okay, so - - -

**MR GRUEN**: So, then you've got to - so, you've got to decide on the costs and benefits of these two markets, as the Chairman was saying.

**DR KING:** Okay.

**MR GRUEN**: Yes.

**DR KING:** Yes, okay. So, let's now take a different - slightly different scenario.

**MR GRUEN**: M'mm.

**DR KING:** So, the next downturn. So, let's say - obviously, there's going to be fewer loans out - take your approach, there's fewer loans out in the private sector, but they're the higher-risk loans. Maybe not 90 LVRs, but maybe they're not writing anything above 80 LVRs.

**MR GRUEN**: Yes.

**DR KING:** But there's a downturn, which inevitably happens in these sorts of markets. You would expect the government just to stand on the sidelines and say, "Well, we're not giving any guarantee," or is there a guarantee on these private loans?

**MR GRUEN**: Well, that was - when I talked to Martin Wolf about it, he immediately jumped to the conclusion that it might be no longer necessary. I don't - it's not a - that's a detail to be worked out. If you - if it - you can see a case for it, you can see a case against it. It changes a lot. But it's possible to argue, and I don't claim - I mean, I don't claim I - and I would suspect I would be suspicious of anyone who could claim that they really know.


© C'wlth of Australia

If you went to this system, whether the extent to which you need some sort of residual system like the one we have now for the whole box and dice. You can certainly see a lot of things that you don't need to worry about, because you've got a functioning payment system, for instance. So, it's arguable that you don't need it; I'm not arguing that particularly. Those are the kinds of things you might have considered in your report.

**DR KING:** And I'll finish up in a second, Peter. Do you see these commercial banks as being - as funding their loans, and they're still making loans, these particular loans.

**MR GRUEN**: Yes.

**DR KING:** Do you see them being funded by deposits, or are you thinking they're going to go to complete wholesale?

**MR GRUEN**: It's up to them.

**DR KING:** No, so - - -

**MR GRUEN**: Well, okay, I take it your point is that it will be harder to fund via deposits.

**DR KING:** If they are funding via deposits, then do you believe that the government would stand back and let those depositors lose their funds?

**MR GRUEN**: Well, they would be - those deposits of the private system in that - in that situation are likely to be paid a higher interest rate, and then you have the kinds of dilemmas that we now have with, you know, Pyramid Building Society and those kinds of things. So, I don't have a "yes" or "no" answer to that.

**DR KING:** All right. So, I think Pyramid is a - and I'll leave it at that, you know, is what you're doing creating a private bank - a government banking system, which if it doesn't get a monopoly in deposits, it will end up leaving a commercial rump which are a bunch of Pyramid Building Societies?

**MR GRUEN**: No. I'm sorry, I think you're - I think you're playing some word games there. I'm saying that you have transformed the nature - these are - quite the case, I completely concede that deposit funding of commercial banks in this model would be likely to attract higher interest rates and would, therefore - and high risk, there's no question about that.

We have a system at the moment that is designed to somehow paper over that in order to provide us with a payment system, for instance. There are - in the age of the internet, we can do better than that. That's the argument.

**MR HARRIS:** Well, I'm afraid we've reached the end of our allocated time. We have the Consumer Action Law Centre coming up next. So, I don't know Nick, I doubt we've


© C'wlth of Australia

satisfied you, but there will be opportunity if these senior public servants are very interested in this will - - -

**MR GRUEN**: I thought my allocated time was - so, the allocated time was to - - -

**MR HARRIS:** 12.10.

**MR GRUEN**: 12.10, all right. Well, I was brought on ten minutes late.

**MR HARRIS:** Okay. Well, I'm just trying to stick to my schedule, so I thought we were - - -

**MR GRUEN**: Bored.

**MR HARRIS:** Anyway, thanks.

**MR GRUEN**: Okay.

**MR HARRIS:** So, I think we have the Consumer Action Law Centre. When you settle, if you can identify yourself for the record too, that would be great. Yes, the water, the water.

**MR BRODY**: Thank you very much for having me present today. Gerard Brody, I'm the CEO of Consumer Action Law Centre.

**MR HARRIS:** Do you have an opening statement?

**MR BRODY**: I do, I do. Consumer Action welcomes the draft report published by the Commission and many of the recommendations. I'd like to start my comments on three areas of the report: proposals to strengthen the power of consumer choice; proposals to address barriers to effective competition, like conflicts and commissions; and proposals relating to technology payment systems and open banking.

Before I do that though, I'd like to make the point that while we support efforts to make switching easier for consumers, the evidence shows that providing more information and a few prompts will not overcome consumers' perception that the potential benefits of switching are simply not worth it. Sticking with the same product and provider can be a rational decision.

Consumers, we believe, should not be penalised for this loyalty; the result should be neutral at worst. Remedies that focus on prompting consumers to switch do not encourage firms to treat their existing customers fairly in the first place. That said, we'd like to voice our support for the discussion and draft recommendations that strengthen the power of consumer choice in insurance.


© C'wlth of Australia

In 2015, Consumer Action called on insurers to be more upfront with their yearly price rises on renewal notices. We surveyed the community and 86 per cent of those surveyed wanted the change. We called on insurers to include on renewal notices not only the price of the premium for the forthcoming year, but also the price paid last year and the reason for any change.

Unfortunately, there hasn't been any meaningful response from the industry. This change, we think, will do two things: first, particularly if the renewal discloses a premium increase, it would prompt people to question the value of their own insurance and shop around; second, information about the reasons for increased costs might help people take steps to mitigate their risk. For example, if they live in a cyclone-prone area, they might learn about what changes they can make to their property to reduce their risk and premium.

We also strongly support the proposal to extend a deferred sales model to all add-on insurance products and sales channels. The harm caused by junk insurance, as we call it, is immense. In our submission to the Royal Commission into Misconduct in the Banking and Finance Sector, we estimated that the misconduct in the add-on insurance industry is likely to cost consumers over a billion dollars over the last ten years. That's money that should be returned to consumers' pockets.

Since 2016, we have run an online tool called Demand A Refund which enables people to complain about the sale of add-on insurance and request a refund from the insurer or financier. Almost $1m has been claimed through the site. While most of the complaints relate to car dealers, around 33 per cent relate to other sales channels, like banks or finance institutions, so it's clear that the harm is occurring in other sectors.

An effective deferred sales model will break the sale between a loan and insurance, reducing the opportunity for pressure. However, it is important there is careful design of a deferred sales mechanism. Unless it is robust, there will be circumvention and regulatory gaming.

We've already seen proposals for bridging insurance covering the deferral period, which would establish a new opportunity for high-pressure selling. Examination of gaming or circumvention is important, because the real core of the problem is commission selling. The use of commissions drives reverse competition, where insurers are competing for access to the market through car dealers, banks or other sales channels.

This additional cost does not deliver a public benefit. That is self-evident when we see claims ratios of less than 10 cents in the dollar. We would encourage the Commission to require industry to set claims ratios that deliver consumer value, and then demonstrate that they can meet those; a performance standard, if you like. Such a reform would provide an incentive for insurers to compete in a way that benefits customers.

There are other product-bundling practices in the finance sector that we consider should be examined as well. For example, the practice of bundling mortgages with credit


© C'wlth of Australia

cards. This is inherently anti-competitive as it hides the true cost, makes switching more difficult and raises responsible lending issues.

An EU report from 2016 that collected and summarised the evidence on barriers to effective competition in the European mortgage market noted that it did not find any compelling evidence that such practice was justified by efficiency purposes.

I would also like to voice support for the Commission's draft recommendation on home loan pricing disclosure. Unadvertised discounts are likely to mean that less savvy consumers end up paying higher rates, because they don't know to push their lender. As I said at the beginning, in a competitive market, people should not be punished for being less literate or engaged.

To make sure that publication of a benchmark rate or rates actually helps consumers, we would encourage this idea to be consumer-tested. We think for it to be effective, it will need to be as simple as possible and - to enable people to understand it. The Commission's draft recommendation talks of a tool which can respond to different combinations of loans or borrower characteristics. We suspect that the more complex this is, the less likely it will be used. Benchmarks work best for consumers when they are easy to understand and clear.

I'd like to respond to the Commission's recommendation about - around brokers and the proposed best-interests duty. Brokers act to - sorry, act as advisers to consumers, and the public expectation is that they are acting in the customer's interests, so this recommendation is very welcome.

However, there does not seem to be - there does not seem to be a clear policy reason for the best interest duty to only apply to brokers owned by lenders. We consider that it should apply to all brokers. I must say that in our legal practice, we rarely see a broker sale add value to a consumer. Rather, the broker is used to find credit that is unaffordable.

We also support the view that mortgage broker commission structures weaken competition and switching. I'd like to particularly make a comment about clawbacks, which are really an anti-competitive exit fee in another guise. Exit fees on mortgages were outlawed in 2011. We've had complaints about clawbacks. On one occasion, our client was unsatisfied with the service provided by the broker and wanted to refinance the loan so as to no longer be associated with that broker.

The broker later contacted the client advising that their commission had been clawed back by the lender and so the broker was in turn clawing it back from the customer. The amount claimed by the broker was in excess of $2,000 and requested within seven days. Clawbacks that charge consumers, we think, should be banned.

Finally, on technology, and payments systems and open banking. We're very supportive of the ePayments code being mandatory and consider that it can be strengthened. Mandating the ePayments code has been recommended by a number of inquiries, but we're yet to see it come into effect.


© C'wlth of Australia

Liability arrangements for the ePayments code should be maintained and extended to open banking. The ePayments code includes the longstanding principle of banking law that the financial institution requires the mandate of its customer to validly debit an account, and that only in exceptional circumstances can a customer be held liable for unauthorised transactions on their account.

We do understand the open banking proposed for Australia is to only allow read access to people's accounts, not write access, like there is in the UK. However, it's important that this sort of principle be maintained. Banks hold a position of trust, and it is not only fair but also efficient for them to be responsible for a third-party access to customer information or accounts. Banks are in a much better position to ensure security is robust.

The final report into open banking, recently released, identified a scenario where a bank shares customer data with a third party, but the data is inaccurate, incomplete or misleading. The third party then offers the customer a product based on that misleading information and the customer suffers loss. The report says the bank should not be liable for the product of the data recipient. This sort of outcome, we think, seems fundamentally unfair. Really, the principle should be that a bank is liable and it should seek recovery from the third party.

Finally, we'd like to make a few points about customer consent in a fast-moving market. We think it's a concept that needs to be fundamentally revisited. To really give consumers power in a competitive market, consent cannot be hidden in terms and conditions or through pre-ticked boxes. Consent to sharing data with third parties cannot be a condition of accessing a service or product.

The Open Banking Review did say that express customer consent should be explicit, fully informed and be able to be permitted or constrained to the customer's instructions. We think it should go further: consent must be separate, voluntary, clear, specific and time-limited. Consent also needs to be able to be withdrawn and withdrawn simply.

We would urge the Commission to recommend that industry develop a standard to make sure consent operates pro-competitively, not anti-competitively. Thank you.

**MR HARRIS:** That's very comprehensive, thanks for that. Do you want to start off?

**MS ABRAMSON**: Well, I was going to start off a little bit - I wanted to ask Gerard about general advice. Are there other issues that you want to do first?

**MR HARRIS:** No, no, just start there. I've got a list of things that came out of some comments. I need some clarification on consent at the end, because I didn't quite - but we're going to come to that.

**MR BRODY**: Sure.


© C'wlth of Australia

**MS ABRAMSON**: Yes, I just wanted to ask Gerard about this whole concept of general advice.

**MR BRODY**: Yes.

**MS ABRAMSON**: And, you know, a lot of evidence about this being misleading to consumers, but it comes back to this difficult point: what is it that you can actually propose in the area? So, I'm interested in your views and, also, a little bit more directive is, whether you think there are specific products which require specific types of disclosure. Kind of around the tier 1, tier 2-type conversation.

**MR BRODY**: I think that idea of general and personal advice and the different levels of obligation for officials who are advisers within them are sort of the wrong framework to begin with. I think what we need to be thinking is that if an - the obligation is on product issuers about the decision that's made at the point of sale, but also, on product issues around products - how they design products and whether it's suitable for who they're trying to sell it to.

So, then when you think about those that are involved in the distribution and sale, and particularly whether advising people, whether it's finance advisers, whether it's mortgage brokers, whether it's debt advisers, which I think is an area that's entirely unregulated at the moment, they need to have a best-interest duty.

**MS ABRAMSON**: I missed that, what advisers did you say?

**MR BRODY**: Debt advisers, for-profit debt advisers. They don't at the moment fall within the scope of the financial services regulatory framework, but are out there in the marketplace telling people how to consolidate their debts or how to deal with insolvency options. Those sort of bodies, I think, need to have a best-interests duty, so they are, as there is in financial advice, that should be extended to mortgage broking and debt advice. So, I think the concept of general advice doesn't fit in that framework very well.

**MS ABRAMSON**: So, I assume from what you're saying that the reforms around product disclosure and I've forgotten the actual name of it, but the new legislation that's proposed to deal with the distribution obligations and things will be things that go part of the way to what you're talking about.

**MR BRODY**: Indeed. So, the product design and distribution obligations, we think that they're a very important reform. We've got some concerns about how they're being designed at the moment.

**MS ABRAMSON**: Yes.

**MR BRODY**: That could be strengthened, which I'm happy to talk about, but they are an important part of the framework.


© C'wlth of Australia

**MS ABRAMSON**: All right, thank you. Peter.

**MR HARRIS:** Okay. So, let's go back to the start: commission and its utilisation in this industry. So, we've had some propositions that, yes, the commissions should generally be replaced by fixed fees. Moreover, they shouldn't alter with the amount of money that's being actually lent. On the other hand, the proposition has been, but if it's a fixed fee and particularly - sorry, if it's a fixed fee and it's paid by the consumer, people won't take advice, there seems to be a reasonably clear-cut advantage in that.

So, I guess, the argument's in favour of commissions, although we'll hear a little more about this from those who want to come in later this afternoon, because the Finance Brokers of Australia are coming to talk to us, but the logic appears to be consumers won't take advice if we change the nature of the system. So, have you got a perspective on that?

**MR BRODY**: I think that that needs to be tested, that claim. I mean, I think that - you know, it's put that consumers won't pay for advice. You know, I think people - the financial advice sector, they are now moving for fee for service and some people are still paying for advice. I think it will depend on different types of consumer sequence. Some people will see value in that service and pay for it.

So, I do think that there definitely should be a breaking down of the connection between, let's say, the amount of the loan size or the amount - the size of your wealth and the advice cost in a commission. So, one - another alternative which I think is worth exploring is that there is a fee for service but, for example, in the mortgage broking market it's paid for by the bank, you know, for the amount of work that it's done, not dependent on the size of the loan.

**MR HARRIS:** Okay, that seems a clear view. You also commented on our pricing - our as close to possible in real time median price for a home loan proposition, which I'm glad actually it's proving to be a little controversial now, because I was a bit disappointed it got so little attention right at the start, because it seems to be a reasonably significant thing that people might actually know before they go into a negotiation roughly what price they might expect, or someone else might have achieved in the reasonably recent past. But it's good that we're getting some attention now.

As best I understood it, you're supportive of the concept, you want to make sure that we don't make it so complicated that no one will access it. Is that right?

**MR BRODY**: That's correct, yes.

**MR HARRIS:** By that, you focused on the online tool and said, "Make it" - so you're, I guess - would I be right in saying you're drawing on experience with comparison websites where it becomes very complicated to get - and you end up getting so many model offers that it was actually pointless getting in the first place?


© C'wlth of Australia

**MR BRODY**: That's correct, that's our experience. Any sort of, I guess, marker in the marketplace about a price, I think it - for it to be effective for consumer decision-making, it has to be simple and clear and upfront. The more steps they have to go through to work out what is relevant for their circumstances, the less likely they'll take those steps.

**DR KING:** Could I just pick up on that? Do you see - there's two ways which you can go down, I guess we've seen one of them in energy where the government - in this case, presumably, the ASIC actually said, "Okay, well we're going to come up with the online tool to do this." The alternative is that, you know, I guess, with what we've seen with the ACCC trying to do in petrol prices is more get the information out there and say, "Come on app developers, come and develop your apps so that people can use them," and we are seeing some activity in that space in petrol prices in Australia.

Which of those directions - if we're going to have an interface that consumers find friendly, and so on, which do you think is the better way to go?

**MR BRODY**: Look, I think that's a really tough question, because our experience is that there are obviously benefits in a government-endorsed portal or tool, because it's free from conflicts and it can be trusted more by the community. But that said, they're generally not as dynamic, not as user-friendly, sort of, tools. Whereas ones produced by the private marketplace tend to be simpler to use, but they can be harmful when there are hidden commissions or payments that drive particular outcomes.

So, I guess, that if we were to go with a marketplace one, we should have a stronger framework of consumer protection around it, around all the standards would be for that sort of thing.

**MR HARRIS:** Okay. And imposing a duty to act in the borrower's best interest on a broker, do you think that's a good step but you wanted it to be comprehensive across all brokers? Is that - how can I put it? Is that an in-principle desire or is there an experience that suggests to you that that - you know, problems actually do exist with small or unaligned brokers that suggest they too should carry the kind of responsibility.

I mean, you would have read the report and noted that the ownership itself seems to us to be a significant conflict of interest in terms of a bank owning a broker. But going beyond that, there's also the possibility that the incentive payment systems could - although that's where we're a little wary about this whole question. So, it does relate back to the commissions thing. But you're saying you want it to apply to all. So, can I draw you out a bit on some basis for coming to that conclusion?

**MR BRODY**: Yes. And the basis is linked to, I think, primarily commissions which drive behaviour of brokers. I said in my opening remarks that in the disputes that are brought to our legal practice, we rarely see a broker add a value to a customer. The broker is rather used to find finance when other mainstream lenders aren't willing to provide it and, therefore, it's more likely to be an unaffordable loan with responsible lending issues.


© C'wlth of Australia

So, I think that that broker does that because it gets - it's looking for a commission, it's looking for a payment, and we see that commonly in the car finance area, but in other areas as well.

**DR KING:** Right. Can I just follow up on it a bit about knowing - you would be aware of the press reports following a broker report - - -

**MR BRODY**: Last year.

**DR KING:** Yes.

**MR HARRIS:** About the middle of last year.

**DR KING:** Off the top of my memory, suggesting that in the mortgage space there was significant - not necessarily putting in documentation, but fully reflected the truth of the borrower. I guess, one thing is - I'd be interested to know if you see that in your legal practice and, secondly, do you think that a best-interest duty would be enough to, sort of, bring those players back into line?

**MR BRODY**: We do see that sort of thing and, yes, it is often on the advice of a - the person, whether it's a broker, it's a car dealer, it's an introducer or someone that's helping someone access a loan product across all the various markets. Can encourage people what to put on applications that may not always be correct. So, that does - we do see that happening.

The best-interest duty would go some way, I think. It would give the consumer in that position a bit more of a - perhaps, a remedy in relation to when that duty is breached. I guess, that one of the big problems we see with responsible lending more broadly, it's from the individual's perspective. The remedy is often not a very good one, so you would get put back into the place you were before you took out the loan, which often means that you might get interest and fees waived, but you still owe the principal, because you got the benefit of the principal.

**MS ABRAMSON**: And I'm sure you Gerard - if you don't mind me interrupting - that best interest would allow you to claim, what a misleading or a negligent-type and that would lead to different - - -

**MR BRODY**: Potentially, that's right.

**MS ABRAMSON**: Potentially, yes.

**MR BRODY**: Yes. We do think that if the remedy for an irresponsible loan was, say, debt waiver, then that would focus the mind of lenders and brokers to make sure it was - they were complying with the responsible lending requirement to begin with.


© C'wlth of Australia

**MR HARRIS:** The codes that currently guide this industry in this area don't allow that to happen. Is that right?

**MR BRODY**: No.

**MR HARRIS:** So, in a sense, your argument is, you need some external regulatory intervention here. As you can, I'm sure, read from the chapter in the draft report, we waxed and waned a little about whether it was essential to have, as it were, black letter law here, or whether there were other mechanisms that, for example, banks might arrive at themselves for imposing the duty of care on their own bank-owned brokers.

This is actually one of the reasons why we're saying in this area you have to come up with something to affect the bank-owned brokers. Banks could possibly offset that, but you're, by the sound of it, lacking in confidence that that would be a sufficient solution, primarily because enforceability of the solution may be unclear or uncertain.

**MR BRODY**: Yes, I think that's right, and I think, yes, as I said, I think that the - there are a lack of consequences for the lenders and brokers when these duties - or where people are put into unaffordable loans is an issue, and it doesn't necessarily provide that right incentive for them to lend responsibly to begin with.

**MS ABRAMSON**: Can I just ask, and it might be because I'm not, sort of, quite firm myself, but do you have a dispute with the mortgage broker that goes to the dispute resolution body? But aren't there circumstances where the loan - as a consequence of an ombudsmen-type scheme, the loan may not be, you know, regarded as a valid loan, or is it only ever going to be waiver of fees or - - -

**MR BRODY**: In the main, the legal principle is to put you back into the position - - -

**MS ABRAMSON**: Position, yes.

**MR BRODY**: - - - you were to begin with, and that will depend on a range of things. But most cases you'll have to - you've got the benefit of that principal. So, if you bought the car, you have to pay for the benefit of using the car for a period. The car is sold, you've got the home likewise. So, you know, that's what I'm saying, it's not as efficient enough, sort of, remedy at the individual level.

**MR HARRIS:** Then finally from me anyway, on consent, so you suggested that - and I don't know whether this is directly our draft report or a more generic proposition, but you're suggesting - well, I took your remarks to suggest there was an insufficiency in current arrangements around a consumer's consent to have their information utilised by a party considering them for a financial transaction. Is that driven by the advent or the probable advent of comprehensive consumer credit reporting or is it driven by something else?

**MR BRODY**: It's broader than that, I think. So, we see already businesses when - we're actually about - my organisation is about to release a report this week on lead generation


© C'wlth of Australia

as a marketing tool, which has, sort of, considerably grown in the online environment, and the way in which marketing companies, you know, put competitions online or a survey, and that's used to gain your customer details, that are then passed on to a third party to market your particular products.

They rely on consent practices. They, you know, by ticking a box or in the terms and conditions, that customer has consented to receive that sort of marketing. And what we're saying is that the consent practices by most businesses, I think, in Australia, and clearly in the finance sector, importantly in the finance sector, tend to rely on not bringing to the attention to the customer important facts and, sort of, bundling consent into terms and conditions or other ways.

So, what we're saying is that we'd like to see - particularly around important areas like sharing information, that there be a stronger consent regime, and potentially - we don't have a particular view about what it looks like at this stage, but potentially a standard of some type that must be complied with to get customers' consent, and that allows consent to be withdrawn. You know, once you've ticked those boxes, sometimes it can be very hard to, sort of, untick them, and stop - once your data's gone, it's gone, if you like.

**MS ABRAMSON**: Gerard, does some of that though come into unfair contracts? So, you're talking about conditions that are imposed. The one I was thinking about, which was brought to my attention, was disclosure of a PIN and then, you know, the bank would have a right to say, "Well, actually, we don't have to cover you in those circumstances." But it seemed to me that some of those conditions - I'm not putting it as a live - just by way of example. But some of those type of conditions might be deemed to be unfair contract terms. I'm not talking about negligence, I'm talking if somebody comes along and steals your PIN.

**MR BRODY**: So, are you talking about - sort of, there are some, for example, pay-day lenders out there that use what's called screen-scraping technology. So, as part of applying for the pay-day loan on line, you hand over your banking password, and these days they're also handing over their myGov password, so they can get - they can sort of scrape your income details from Centrelink and your - - -

**MS ABRAMSON**: No, I wasn't actually referring to that.

**MR BRODY**: Yes.

**MS ABRAMSON**: But that - you know, I wasn't aware of that. I was thinking about traditional banking.

**MR BRODY**: Right. So, where that's an unfair contract term, look, it may be arguable - I don't know of any, you know, regulators that have looked into that analysis. Generally, it's presented as a condition of getting the service. So, yes.


© C'wlth of Australia

**MS ABRAMSON**: No, I was just interested. One other thing, if I may, Peter, I just wanted to ask about is underwriting of insurance products, you will know that we had a reasonable amount to say about - I think we used the words, "A blizzard of lots of products, but not much choice." But in - how would you make - say, you had a regulator said, "Well, here are all the products that are underwritten," or even on the insurer. So, how would you go about ensuring that a consumer actually had an interest in understanding that information? Like, we talked about that with loans, how do you make it so the consumer actually thinks, "Well, that's something I should check out."

**MR BRODY**: I think that's really difficult, and I think we might be, you know, in some sense, putting our head against a brick wall if we think consumers necessarily kind of care. They're going to care about what's been told with them at that point of sale, and particularly the advertising practices. Some of them over a phone sale, interaction, or what's on - showing them online. So, I guess, if you really wanted the consumer to know those things, it would have to be served into that point of the transaction.

**MR HARRIS:** Sorry, I didn't want to get off consent before asking. The hardest thing for me though is solutions on consent, because this - once you've given it, it's gone. How can you recreate a circumstance where someone has to reaffirm? In a lot of ways, they probably won't even know what the information subsequently will be used for, will they? So, it seems just - it seems very tricky to give a person the ability to reconsider. Moreover, if you started down that path and imposed an obligation but it was undeliverable, then aren't you, sort of, almost discouraging a lender from being in that business at all, because now there's a liability that I can't discharge if I get him to consent again, because, you know, it's proven to be impracticable.

**DR KING:** Or there's a risk that you create a law that's just simply unenforceable.

**MR HARRIS:** Yes, I'm not against the concept.

**DR KING:** Yes.

**MR HARRIS:** - - - I'm just trying to - - -

**MR BRODY**: No, I appreciate that, and I guess that I'm not sure that we have all the answers on this issue either. I guess, what we'd like to see is, yes, some further inquiry and analysis into how to make consent in a, you know, modern, online market economy environment, work pro-competitively and not anti-competitively in a way that sort of reduces real customer choice.

**MR HARRIS:** Because in the US they've had some quite significant problems with people hacking consumer information sources and there's been a very serious one late last year.

**MR BRODY**: Yes.


© C'wlth of Australia

**MR HARRIS:** The first solution from the consumer credit entities is to tell a customer that you can freeze access to your information. But, of course, if you freeze access of your information, then if you're in a circumstance where you're still involved in a transaction, the transaction will fall over.

If you were in a, what I might call a circumstance where you're persistently likely to want to access credit temporarily, and that's credit cards, and you freeze access, your credit card could die on you. So, it doesn't seem to be a solution to go down those sorts of remedies that we saw in the US.

**MR BRODY**: I think, as I understood the freezing access to your credit card report is your freezing as to that information. It doesn't stop you using existing credit products, because there's no reason for your credit provider be consistently checking your credit report. They generally only look at it when, you know, you apply for a loan. That's the point they look at it.

So, yes, it would have implications if you were mid-point and going around shopping for a mortgage, that might create problems for you. But for many people, they're not in that moment, and so a freezing a credit report at that stage while - it might be a useful thing for them.

**MR HARRIS:** Okay. Well, I tossed it out there deliberately to see whether (a), you thought about it and, (b), when you had something, because that appeared to be - I mean, the US financial system is different to ours, obviously, but it appeared to be at least something that people generally thought, "Oh, well, that's probably what you can do, it's probably" - now, it's for a different circumstance, it's for a hack, but if the concern was consent needs to be re-established - - -

**MR BRODY**: I guess, the other thing I would say in that circumstance is to think about how you can compensate the customer. So, if they, for example, were going to shop for a home and they missed that opportunity, you've got to compensate - compensable loss that that credit body, perhaps that didn't have the appropriate security standards, that allowed the hack should be liable for.

**MR HARRIS:** All right, that's quite interesting. Stephen, do you have - - -

**DR KING:** Not on credit - - -

**MR HARRIS:** No, we're moving off topic.

**DR KING:** Okay. So, there's a couple of - let me do a couple of quickies. Firstly - which have no connection to each other. Firstly, you mentioned commissions and issues of commission. One of the things that you might be able to very quickly help me understand, internal bank issues haven't been raised to us. Now, internal bank issues, obviously, have been a huge issue in the States, for example, Wells Fargo and their internal incentives. And


© C'wlth of Australia

it's not the sort of thing that we can actually ask the banks, "Oh, your internal incentive system's stuffed."

I mean, any views on that? I mean, it literally just has not been raised to us and so is it the case, well actually the banks, internally at least, don't seem to be - you know, the Wells Fargo case, it was the incentives to open accounts in people's names even though they didn't know about it. I mean, that's an extreme, but do you see anything happening in that space?

**MR BRODY**: Look, I think that has been an issue. Both the individual incentives for bank staff, but also targets that are put on bank staff does drive behaviour in banks that put people into particular products. I think the example of consumer credit insurance is a key example. So, you've recommended deferred sales mechanism be brought in - be on car yards. I think banks would be a perfect place to add it to for exactly that reason.

So, I do think that's an issue. Look, there has been some changes in the banking industry that they've adopted in the last 12 months following their own review that was conducted by Stephen Sedgwick. I think a lot of his recommendations around this issue were very sensible. What is more difficult to follow, if I'm honest with you, is the extent to which the banks have implemented those. I try to follow it by looking at the various media releases they put out, but there's no, sort of, one central place where you can really work out to what extent they have implemented those recommendations. I think understanding, that would be more helpful, but, you know, I think for example, the consumer credit insurance is a good example of the way in which incentives encourage - - -

**DR KING:** Yes. No, that is one that's obviously been brought up to us before. Yes, good point. The final one I had was just on funding, which you've mentioned in your earlier submission, your submission at the Royal Commission, I think you mentioned it as well, you mentioned it in the introductory remarks here, particularly with credit cards and the bundling. I'd just like a bit more detail on where you actually see the problem there with that.

**MR BRODY**: There's a couple of different problems. So, I think that once you bundle a product grouped together, particularly a mortgage with a credit card, it does make it difficult to switch. There are barriers to switching, because you've got to switch - you can't, sort of, untangle the bundle often very easily. If you want to get a credit card over here, if there's suddenly a better deal at a different provider, maybe you've lost the benefit associated with your mortgage. So, that's the first barrier.

I think that we see more fundamental concerns with responsible lending issues. So, people have gone to get a mortgage. They had no intention to get a credit card, that wasn't part of their requirements and objectives as the law requires the bank to access, but they're - "You know, this is the bundle we've got."

**DR KING:** Yes.


© C'wlth of Australia

**MR BRODY**: So, suddenly they're with - they've got a credit card as well, and, you know, our view is the credit card is a very dangerous product that can lead to unmanageable debt quite easily, and that's the responsible lending aspect too we're concerned about.

**DR KING:** Okay, so yes, it is the case that you pay the flat fee per year through your bundle.

**MR BRODY**: That's right.

**DR KING:** But there's a credit card thrown in for free.

**MR BRODY**: That's right.

**DR KING:** Effectively, it's a credit card.

**MR BRODY**: That's right.

**DR KING:** No, that's good.

**MR HARRIS:** Julie.

**MS ABRAMSON**: Yes, I just had a final question, which is really - one of the things that we've been thinking about, because, of course, we're looking through a competition lens, is - and I've heard everything you've said, Gerard, about duties - the duty of best interest, but about planners, wealth management advisers advising on loans, and I wondered if you had a view about that, because it may be tied to what standard you think people might - - -

**MR BRODY**: Yes. Look, I would encourage you to think about that issue, and I think you also need to look at people, I guess, outside the finance sector and their role, like real estate agents and others in terms of the incentives that are provided to them to direct you towards particular products offered by particular lenders.

You know, I don't think there's anything wrong with a financial adviser providing you with a full service and, you know, if you are seeking a loan, then that might be quite convenient and helpful, but they should be regulated by the same standard.

**MR HARRIS:** We did get - we had FINSIA. Now, I'm not going to get the acronym right. We had FINSIA as a submitter last week and came to hearings, and they were talking about the difference between professional standards as required by a financial adviser, a wealth adviser, if you like, in my simpler terms versus a mortgage broker. Didn't have the same requirements for professional standards, and this seemed to be a matter that you might address in the context of if you were to, as it were, put mortgages in as an asset that a financial adviser would handle, presumably, because they've got a - they've got already, you know, a requirement for - to meet particular quality or educational standards, that that could actually be a benefit to borrowers in this market versus a mortgage broker.


© C'wlth of Australia

Do you have a view on, sort of - given that you presumably see them from time to time, both, do you have a view on that?

**MR BRODY**: I think that at a general level we should be encouraging professionalism across all these sectors, and they should have similar or, you know, the same sort of standards when it comes to education and continuing professional development, and training, and so on. So, I guess that I'd hope that, perhaps, yes, the financial advice sector, there has been the obligations placed on them under law reform and under industry codes of practice. If they could ratchet up what happens to the mortgage broking industry, then that would be positive.

**MR HARRIS:** All right. Can I ask just a broader - this is my last question around a broader proposition. We are trying to get a view, not so much, perhaps, of direct interest to your centre, but we're trying to get a view on ASIC versus the ACCC as the potential competition champion. And, I guess, because you see both of them in action in marketplaces where you are, even though the proposition we have in mind with a competition champion is one where they will be working at the highest levels, you know, through the Council of Financial Regulators and that kind of thing, nevertheless, because you see them in action, did - when you read the report and struck this recommendation, did you have a reaction to it that said one or the other is more likely to be, you know, a useful party to be appointed by the Treasurer as the competition champion?

**MR BRODY**: I think that our view would be that the - it would be more effective for the ACCC to play that role. They've obviously got competition as their mandate across the economy. They've recently been given a new bucket of money, as I understand it, they've developed a unit. Perhaps that needs to be expanded and more money given to them if they were to give this ongoing competition champion role, but I do see fitting in with that function they've already been given.

That said, I don't see - and I know that ASIC has put forward that it should have, sort of, competition among its objectives as a regulator, and I think that would be a good move as well. There are various decisions or, you know, regulatory decisions that ASIC makes that, you know, a pro-competitive lens might give them more power to make a good decision that benefits customers.

So - and they are doing many things about that, I guess. So, for example, they are looking at the deferred sales measure in car finance, and that looks to be something that ASIC's able to implement. But I think if they had a competition, some objective, that would give them strength to make those sort of regulatory interventions.

**MR HARRIS:** So, you're really saying, shrink the both of them, rather than necessarily having a preference for one?


© C'wlth of Australia

**MR BRODY**: I think that at the high level though, the main focus of competition, it sits with the ACCC. You know, ASIC's main focus is around, you know, enforcing compliance with the law and ensuring that there are those perverse outcomes in the marketplace.

**MR HARRIS:** That does it for me; are you guys done? We are only one minute past time. As good as my record in Sydney last week, where we were absolutely on time both days. So, Gerard, thank you very much for your time.

**MR BRODY**: Thank you.

**MR HARRIS:** Your original submission and participation today, hopefully, ongoing access to your background. So, we're going to take a break now for lunch and restart at two with the Finance Brokers Association of Australia. Thanks.

**ADJOURNED** **[1.02 pm]**

**RESUMED** **[2.05 pm]**

**MR HARRIS:** We're now back in session, and I think we have the Finance Brokers Association of Australia. Could you identify yourself for the public record please?

**MR WHITE:** Yes, certainly. Peter White, I'm the Executive Director.

**MR HARRIS:** Peter, do you have some opening comments to make?

**MR WHITE:** Yes, I do. I'll just give a bit of background and there's some points that I'd sent through that I'd like to comment on. So just for a bit of understanding, the FBAA was established in 1993 and is the leading professional body for finance and mortgage brokers nationally, representing over 8,200 members and additionally some 13,000 industry stakeholders.

Myself, I am a 30 year industry practitioner with extensive experience in retail banking, non-banking, private investment banking, mortgage management and broking. A couple of things of note, I established RAMS's first sales office in the early 90s and was Mark ...(indistinct)... CEO or first CEO was at home loans in the late '90s.

Since 2003 I have been Executive Director for the FBAA, part of the executive team, volunteering my services until 2010, where I took over responsibilities as CEO and still today head the business association as the executive director, key responsibilities being government, media and strategy.


© C'wlth of Australia

Today there are five primary items I have listed for comment, being that of lenders mortgage insurance, global commission practices, claw backs, broker market size and of course Australian broker commissions, and I will address them in that order.

So firstly on LMI, just as a point of note I was interested to read that there was a pull out comment made by me in the PC's paper that was made from around 2011, and it's now some nearly seven years. Although those comments might have been accurate at that time, they may not necessarily be representative in today's market place. It was a comment where it says that the national president of the FBAA, which I was at that time, said that about 90 to 95 per cent of people didn't understand what LMI was.

Correct then, I wouldn't put my hand on my heart and say that's necessarily the data as of today.

**MR HARRIS:** I don't want to break your flow up, but are you actually saying you want us not to use that quote?

**MR WHITE:** Well, it was accurate at the time, I guess it was a point in time, it's not today.

**MR HARRIS:** No, what we do in our operations is going through and sieving things. Someone says something and we think, "Well, that's reasonable, interesting and reasonable".

**MR WHITE:** It was reasonable at the time.

**MR HARRIS:** Okay, we'll bear that in mind, thank you. Sorry, keep going.

**MR WHITE:** Also following on in the lenders mortgage insurance space, there was various media commentary being editorialised by CHOICE where it says the abolition of the insurance, LMI, as it is not insurance that provides any value to the consumer, it provides value to the lender by insuring them for risk of default.

The closing comment relating to the relationship between lender and insurer in isolation is correct, but it is not complete. Without LMI rates would be higher as the cost of funds would increase, and buyers would not be able to borrow the 80 LVR, the loan to valuation ratio, and possibly restricted to much less than this.

The FBAA is the original and leading advocate for better disclosure of LMI as it should be disclosed in the key fact sheet to a home loan, as was agreed by the Treasury Working Committee to the NCCP, where progression to implementation was stopped on 15 February 2013 due to a pending federal election later that year. We believe that most certainly disclosure piece needs to be correct and not buried within the documentation of a loan.

Further to such disclosure however, LMI should be formally discussed at the very beginning of an application process by all brokers in the market place and lenders alike, as


© C'wlth of Australia

disclosure and comprehension are not synonyms, you need to educate. The discussions around portability and proactive rebates is something that is worthy of further discussion, but I won't touch on it terribly much at this point in time.

Looking at the global market place, there is various commentary in the market that says that brokers in Australia are amongst the highest paid in the world, but this inaccurate. In 2016 the FBAA conducted global research which analysed brokers' home loan commissions across seven countries and the results showed that Australian brokers are actually amongst the lowest paid in the world and amongst the only ones that suffer claw backs in the manner which they do. I'll talk about claw backs next.

I do have a copy of that research paper here if you would like it.

**MR HARRIS:** Sure.

**MR WHITE:** And a summary of it as well. Additional commentary refers to that brokers are being paid a lot more than what financial planners do, and this too is not the case. Various commentary in the media refers to financial planners being paid $100 to $700, yet our research shows that up to $1 million of assets under advice. Financial planners charge 0.75 to 1 per cent as an upfront fee, and 0.25 per cent on an annual renewal or review, if you like, the equivalent of a trail. Once the amount under advice goes above $1 million it drops to about 0.55 per cent. And that is as of information to date.

Moving on to claw backs. I'm well known for my advocacy against unfair claw backs in the market place and they need to go. But it's important to note that claw backs only apply to upfront commissions and not to trail in the main. I agree that claw backs may inhibit the movement of loans between borrowers and lenders, plus unquestionably it's commercially unfair.

To do your job, get paid for it, and then risk losing your income for doing your job for up to two years for things which are outside your control is completely unacceptable and this must change. The broker's duty of care to a client is unfairly commercially challenged due to this and this must be removed to ensure the best interests of the clients are always first, without the potential commercial disruption.

Briefly just on broker market sizes. There is various opinions in the market of the size of the broker industry, as commented in the media and various regulatory papers. The FBAA this week will launch what is called the Consumer Broker Index, which shows from the extraction of ASIC's data, as supplied by them, that as of April 2017 there were 26,037 consumer brokers and businesses in Australia.

This is broken up by 21,681 credit reps, which are brokers, 4,356 licence holders, which are predominantly businesses, it is 82.23 per cent weighted East Coast and the largest concentrations are in New South Wales, then Victoria and then Queensland.


© C'wlth of Australia

It shows that the industry has been growing at an average rate of 9.16 per cent over the past three years, but is slowing against the average growth over the past four years. Additionally, I have some summarised information in regards to that data, and the actual index will be available as I get through to about the middle of the week. But that is there for yourselves as well, so you can see that.

Broker commissionsare I guess the largest part of this. I'll try and move through this as quickly as possible. I am concerned with some statements that demonstrate possible limited understanding of commissions in saying that mortgage brokers must get consumers a cheaper rate, or that the mortgage broker remuneration needs to be reduced or changed to fee for service.

The FBAA would like to put forward some points, possibly broadening that thinking. In the past the FBAA has made previous submissions on the mistreatment of existing customers by banks, the fact that banks are inherently conflicted and the adverse impact of LMI prohibiting consumers switching loans.

There is an inference that the role of a broker is to get the lower rate for a consumer. This is not correct, as brokers by law provide credit assistance, which does include looking at potentially better interest rates, but is far more than just that and includes product suitability and various other components. By misstating the purpose of a broker, one is then able to go on to suggest brokers are failing, which further allows to suggest the failures are caused by poor disclosure, conflicts and excessive remuneration, and then lead to recommend changes.

Brokers increase competitive pressures, making all rates lower. Alternatively, without brokers consumers would only have the 100 per cent conflicted direct channel option, which is inferior. The broker industry has provided significant positive impacts to market, interest rates margins have come down, lending in the late '70s through to the '80s before brokers were involved saw margins of cost to funds above 4 to 6 per cent on home loans, today it is around 2 to 2.5 per cent.

There is more competition in the home loan market than there has ever been before, and all consumers are the beneficiaries, regardless of whether they use the broker channels or go direct.

The notion of conflict is misplaced. At a basic level, simply receiving remuneration amounts to conflict. An employee receives more promotional opportunities or more money the better the job they do. In sales-remunerated roles, this is even more apparent, yet it does not always equate to poor outcomes.

Direct channels are 100 per cent conflicted; they cannot turn around and recommend the bank next door has a better product or cheaper interest rate. Brokers must offer better alternatives to the 100 per cent conflict of a product provider. How can a broker with product choice be viewed in a lesser light? At worst, a conflicted broker is delivering the


© C'wlth of Australia

same result as a direct channel at no additional cost to the consumer.  The focus on broker remuneration seems to have no end purpose other than to disrupt industry.

The PC suggests there is no transparency in broker fees, yet the commission disclosure requirements under the NCCP are extensive.  The finding also ignores the fact that, without the presence of brokers, banks would be under no pressure to remain competitive or to be looking after their clients.

The real barrier to consumers in switching mortgages is actually lenders mortgage insurance, which is not portable nor rebateable in most cases due to the credit policies.  So the focus on broker remuneration seems misplaced as broker remuneration is a supply side cost.  There is no suggestion that the broker remuneration is increasing rates by consumers or that changing broker remuneration will reduce rates to consumers.

There have been various commentaries in industry media which I would like to briefly address, and one of which - both of these have come from the PC - one is in relation to - the first one is in relation to there is a large apparent additional to industry cost since the mid-'90s, and I would say that the distribution cost has always been there, whether it be branch network costs or for broker networks, which I would argue are around 50 per cent cheaper than branch networks, and lending margins since the '90s have reduced, not increased, so there is no additional cost to industry or borrowers at all.

There is a cost for distribution across all retail business sectors around the world.  In lending it is either the branch fixed fixed costs, or the significantly more cost effective broker variable fixed costs, and additional comment in industry media talks about trailing commissions being designed to increase churn and manage customers on behalf of the banks.

Yes, the reality is that when trail commission first came out it was first as a design to reduce inappropriate churn of portfolios, that was the case.  But over the many years this has been in place trail income, regardless of what is written or the verbiage within a contract between a lender and an aggregator, is it sits between the lender and aggregator, not direct to the broker, the broker's agreement or with the aggregator, is to undertake actual work on behalf of the lender which would normally be done by bank branch staff or by head offices.

This includes such things as originating the loan, so advertising and marketing, and it can take upwards of 10 clients before you actually get the right to work with one borrower. Assisting borrowers to navigate the approval process through to settlement, assisting the borrower post settlement with queries or issues, conducting annual reviews of facilities to ensure that the loans have not become unsuitable as lending and borrower circumstances do change.

Trail does not restrict the movement to restructure or refinance a loan, should such need be the consideration for the best interests of the borrower.  So if a trail stops with one lender, it then restarts with another.  It is not the barrier for movement.


© C'wlth of Australia

The use of brokers evolved from a clear recognition that the valued proposition of using a broker was more attractive than branches and staff.  The proliferation of brokers has occurred because of the benefit derived by product issuers from an expanding broker network and, implicitly, product users know that a broker distribution model is cheaper and more effective than staffing branches, which is why it continues to thrive.

The discussion around fee for service model is not viable, as it will result in consumers having to pay from their own pockets to intermediaries for the services that should be paid for by the bank, i.e. as brokers provide credit assistance.  That would mean intermediaries would earn less, making the profession less viable and see many exit the industry, thus diminishing the influence they have on lender conduct, pricing or service levels, and the direct channel becomes more profitable.  The consumer loses every time.  Thank you.

**MR HARRIS:** Thanks, Peter.  I might try if I can to reverse the order a bit, because I think our primary concerns - I think if we get to LMI, which you started out with, we'll probably be on reasonably solid ground collectively.  But I just want to be sure, you have read our recommendations?

**MR WHITE:** Yes.

**MR HARRIS:** Not just the media reporting?

**MR WHITE:** No, I have read the recommendations.

**MR HARRIS:** Okay, good, because I'm going to be presuming that's the case.

**MR WHITE:** Unfortunately the media influences people's thought process.

**MR HARRIS:** The media is very active and yes, we're all in the same space.  Churn, can I start with churn?  So it has been put to us throughout the course of the development of the draft report, and subsequently, that banks and certainly some brokers believe they are being paid to reduce churn.  You were fairly explicit I think about the fact that might have happened years ago, if I understood what you just said.  The implication of that is it is no longer the case.

So if we were to ask either banks or the aggregators for which many brokers work for a copy of the obligations that they expect as a result of the payments that they're making, would we find, because we have asked for these things and we don't necessarily get access to them, would we find then that there is no obligation to prevent churn on behalf of the broker?

**MR WHITE:** As far as the verbiage is concerned within the contracts, as far as I'm aware, and I haven't read one for a while, so I'll caveat that position, I don't believe you'll find it detailed in that level.  But if you're speaking with any bank it is not a giveaway, you are expected to undertake a certain level of duties that would normally be undertaken elsewhere.  That's why it was given.  And yes, originally it was for churn, because there


© C'wlth of Australia

was a whole lot of inappropriate actions happening in the very early days when this started, and they're the sort of things we wanted out of the industry, we just need it moved on to another sense.

**MR HARRIS:** Right. And yes, you've referenced the - if you like, the alternative to brokers being the branch, and pointed out it's 100 per cent conflicted. If anybody's conflicted, it's 100 per cent conflicted. But equally, it's been argued that brokers are being paid this ongoing trailing commission in order to manage the customer.

Now, that activity would normally then, in the alternative, undertaken by the branch, one would rationally assume that branch's job was to ensure the loan didn't shift to another party. You can see can't you how we could conclude from that that's what a broker is being paid to do, ensure the loan doesn't move to another party.

**MR WHITE:** I most certainly can see where the parallel is drawn as such, between the bank, but there's two different things at play here. I mean, even within the banking system they have proactive teams to ensure that when clients are trying to refinance that they are a retention team trying to hold people in place.

The broker isn't driven by that mentality as far as where trail income comes from. I do understand the thought process, but understand that when a loan closes, it gets refinanced elsewhere, yes, the trail will stop there, but it will re-continue with the next loan. So that service standard gets maintained for the borrower across the premise. It doesn't force them to stop.

Claw back does, because somebody works - does a lot of work to actually originate a transaction, and all of a sudden, for up to two years, you can lose you income for doing your job, which just commercially doesn't make sense. That is certainly a barrier, as well as the high cost of LMI.

**MR HARRIS:** That's right. We could see the claw back was worse than a trailing commission, but it was again put to us, and this is the problem, you only get what you get, that that's pretty much been eliminated. I will not say been, I will say being eliminated. Is that not the case? Should we be worried by claw back still persisting as a preferred activity from the banking side?

**MR WHITE:** In my personal view I believe that claw back is something to be concerned about. I understand the rationale and why it was implemented and it came in when the Labor Government banned exit fees, and there's a whole history that sits behind that. But at the end of the day, everybody gets paid to do a job, and once you've done your job you've ticked that box. Somebody should not commercially then have the right to claim that back over two years. And I believe that is something to be concerned about.

In overseas standards in our global research paper, in America for example, brokers are paid upwards of 2 and sometimes 3 per cent as an upfront commission without any trail, at the high end of scale they have fees they have to pay, but there is no claw back. If the


© C'wlth of Australia

lender finds that you're churning business on a regular basis, they'll tap you on the shoulder and say, "Hey, what's going on". But they are there, at - when you look at the math, at a far more beneficial financial position then Australian brokers are, and that's without a claw back position. So the books churn, which is not necessarily a good outcome.

**MR HARRIS:** No. I think in part that US experience was known to us and was - our view is that there are different models overseas, but I think we're more thinking of France and Netherlands where there are apparently lesser charges - you've said not - which is why we're very interested in that detail because it was again put to us that they were lesser, from a banking institution that should know. But anyway, we'll have a look at the data and see what the data says.

**MR WHITE:** We did look at Holland and it showed that they had moved away from a commissions-based premise to fee for service as such. And most of the fees were sitting around 3000 or 3200 Euros per transaction, which actually went up more.

**MR HARRIS:** Well, if you've got data, we're interested in data.

**MR WHITE:** Yes.

**MR HARRIS:** I have other questions, but I'm going to give everyone else a go.

**DR KING:** We're more than happy for you to continue at the moment.

**MR HARRIS:** All right. I'm very interested in the fact that you are I think the first substantive person, he says, looking at the back row, but anyway, the first substantive person to tell us that you have an estimate, even if it's only your own personal estimate, of the difference between the cost to the banking system of having a broker-oriented network and having a branch-oriented network.

**MR WHITE:** Yes.

**MR HARRIS:** You may or may not know, that's why I asked you about the report, we spent a lot of time trying to get access to data which would enable us to work out whether the price of a broker was justified by the cost savings. And that cost benefit would have helped us because we can see the benefit of a broker, we're just trying to look at the cost and we could get no significant evidence.

I think the Royal Commission - I don't like to say those words too often - but it is interested in this as well. But you at least appear to have some personal estimate, have I understood your 50 per cent comparator?

**MR WHITE:** Yes, I do. Yes.

**MR HARRIS:** Can you tell us a little bit about that?


© C'wlth of Australia

**MR WHITE:** Sure. I mentioned earlier, I actually established RAMS Home Loans' first primary office in the country, back in '93. As we progressed that period in RAMS, into the - as we progressed through the '90s, we were constantly doing an analysis between the branches and the broker networks, and it was literally half the cost as far as being able to run a broker network versus a branch network.

This is simple logical maths that sits behind it and I'll also come back to the thought on banks at the moment. I refer to banks being a fixed fixed cost. So regardless of whether a bank produces any revenue or not, they have a fixed cost that can't be mitigated. So they've got branch networks, staff salaries and so on and so forth. So whether they write loans, gather in deposits, becomes irrelevant, they have a fixed fixed cost regardless of outcome.

With the broker sector you have a variable fixed cost. So cost is quantified that the broker gets paid X out of the transaction, but only if they produce the results, i.e. settlement. So actually inherently by simple logic, far more cost effective.

I find it very difficult for banks to argue that they can't provide that information, they have major business units running broker networks which all have a P and L and we constantly say, "We can't do this", or "We can't do that because it's outside of our budget", someone needs to - so I said, "Well, if you've got a budget, then surely you know the answer to this", no. And they are listed entities and they have responsibilities to the public, so I'd be very surprised that information isn't there somewhere. We have people who now run aggregation firms in this country who have worked in the banks, who do say to me, anecdotally, it is ascertainable.

**MR HARRIS:** And the same would apply surely to business cases when a bank goes out to buy a brokerage. One assumes that there would be an internal business case which says this is the cost that we can save.

**MR WHITE:** Most certainly. They wouldn't be buying something to make a loss over.

**MR HARRIS:** I wouldn't have thought. Anyway, we will maybe persist with a little bit more information, but to the extent that - - -

**DR KING:** Just before moving off that, it's been towards us that it's actually not the right question that we're asking when we're looking at the costs, because the view is, well, the customers who go direct to a bank branch in some sense are different from those who go along to brokers and want the broker to search in their behalf for the best product. So we're not comparing like with like, if I can put it that way. Do you think there's any merit in that argument?

**MR WHITE:** Possibly not. You know, people go to brokers for a myriad of reasons; it's just not to get a cheaper loan. It's service. Many people use products like that are supplied through Harvey Norman and are higher income individuals because it's convenient and they just do it.


© C'wlth of Australia

So there's a service level standard, and I can recall very vividly during the mid to later part of the '90s where banks were closing branches left, right and centre around Australia, which pushed the broker's value proposition up through the roof. So your clients will go to branches for whatever reason they see fit. And usually it's transactional-based, not necessarily lending-based so much anymore. As we know, over 50 per cent of borrowers actually use a broker to originate a transaction.

So to me it's a service thing as much as anything else in regards to what happens at the broker level. And the way branches have evolved over the years, you walk into branches some days and you wonder if there's any staff there. So I don't think that that has the - people are going to branches for that reason.

**MR HARRIS:** I was going to move off the cost number anyway, but very interested - he says advertising - still very interested in the information that we might be able to obtain on that particular issue, for the purposes of - our analytical purpose here is to be able to put the cost on one side and if indeed it looks like it's a rational judgment being made, moreover it should therefore support the cost then paid to the broker for the purpose of the loan, and then you could say to consumers, this is not an exercise of market power. In other words, you're not being screwed.

**MR WHITE:** Yes.

**MR HARRIS:** Not to put too fine a point on it, that's what we're looking for in a competition-based inquiry. Yet when banks buy into the service, that might logically suggest that it's just a different way of extracting some money from a customer. I mean, you can see why we would be in it then, particularly because brokerages, you know, I think the larger ones have been substantially bought up by the banks and so we are just trying to get to the bottom of is this an exercise of market power or is it in fact a legitimate cost that you could say is justified either by cost saving by the banks on one hand, or service to the customer on the other hand, or perhaps a combination of the two, which would be a preferable - - -

**MR WHITE:** I think there's some logic that says it's a cost effective means of distribution. So if you acquire at the right price it's eventually a cheap customer versus a much higher cost of acquisition in the broader retail market space.

**MR HARRIS:** I wanted to ask about your membership. You tell us that you have - sorry, there were 26,000 brokers based around ASIC data.

**MR WHITE:** Yes.

**MR HARRIS:** I'm interested in your membership and the membership of other associations for this purpose of saying that the quality of service is supported by some kind of professional standard. You may or may not have heard, but we had some representatives last week telling us about the professional standards that apply in the wealth management industry, which has had its own particular problems.


© C'wlth of Australia

The professional standards in the mortgage broking industry don't appear to be of the same ilk. Now, that's a relatively recent thing, but I'm interested in that, because you're representing an association. So I'm first interested in do you impose upon your members a professional standard of some kind?

**MR WHITE:** Yes, we do, we have a code of ethics as well as a code of conduct that the brokers have to apply to. One of the interesting examples is that given my - I've been in the industry for a little while; I've always been very concerned that when people are new to industry they actually learn their base knowledge in a very sound manner.

So when the rulings came out for the NCCP back in 2010, our opposite number said that all brokers had to have a diploma. We said no, the law states Cert IV and you need to get your foundations right before you step onto higher education. A review of our membership shows that over 83 per cent of our members have done the diploma or a masters or doctorate degree in a relative finance discipline; they have extremely high professional standards in their conduct.

I did an audit of ASIC's data of their enforceable undertakings, bannings and disqualifications from 2011 to 2016, it showed that 9.45 per cent were our members. At the time of that banning or disqualification only 3.65 per cent were members at that time. We had already dealt with the other lots of problems.

So we see it from - when we look at the market place, that we know from our members' point of view, and generally as somebody who represents industry anyhow in the longevity of being in the industry, that brokers hold a very high professional standard. I don't think the measures with financial planning though quite balance, brokers in Australia can't manipulate markets, financial planners can.

I used to run a private banking suite, they most certainly can manipulate the financial market places or particular products, which they support and refer, there's a different plan.

**MR HARRIS:** Should we be interested in that? I'm not aware of that. How do they manipulate markets?

**MR WHITE:** Well, if you turn around and promote a specific investment product, that particular investment product, if it's done through a business unit, will flourish and increase.

**MR HARRIS:** I see. You're talking about a sort of some kind of pump and dump kind of - - -

**MR WHITE:** Yes, if you like, you can put it that way.

**MR HARRIS:** Well, I need - no, in my terms it has to be like that, I can't deal with - - -


© C'wlth of Australia

**MR WHITE:** No, that's fine.

**MR HARRIS:** I don't want to confuse, yes.

**MR WHITE:** But with brokers it doesn't change.

**MR HARRIS:** I see. No, they can't change that can they.

**MS ABRAMSON:** Don't tell me we're actually going to - - -

**MR HARRIS:** We always give people advice about the evacuation thing, and we think we hope - - -

**DR KING:** Hopefully it's another floor; it doesn't sound quite loud enough.

**MR HARRIS:** Yes. Hopefully it's a long way away. Let's go on. You mentioned that you therefore do effectively discipline your members.

**MR WHITE:** Certainly. We have an ACCC disciplinary tribunal, ACCC approved, yes.

**MR HARRIS:** And that means that they are excluded from being a member of your organisation, but they can continue to offer their service in the market place, can't they?

**MR WHITE:** Yes, they can.

**MR HARRIS:** And this seems to be a problem in the sense of a consumer potentially being misled, a person is a broker, they have to take down their statement on the window that says they're a member of your association, but they can otherwise persist in the market place.

**MS ABRAMSON:** Can I ask a question which relates to that? But in the circumstances where you remove a member because they don't meet your standards, is there any impact on the licence that they hold at ASIC, their credit licence?

**MR WHITE:** No. We would love it to be the fact. The law does not state that you must hold industry membership. We would most certainly be very supportive of that changing so it does, because we can disqualify someone, which means they have to take their shingle down. The disciplinary tribunal, depending on, can award costs to be paid, but outside of that it falls into your - it doesn't stop somebody from operating if they are able to get membership elsewhere, or they don't need membership, which is why you can see there's some disparities in membership numbers versus total market size and there's varied components within the market as well.

**MR HARRIS:** So this is leading up to our act in the consumers' best interest proposition, which again, because it wasn't necessarily clarified in the media, though we tried our best


© C'wlth of Australia

to do it a little bit since then, we were proposing for sure should be imposed upon bank owned brokerages, but we left the question open about independent brokerages.

Now, people have argued in these hearings those directions. But first the principle, do you think the industry should have such a duty of care imposed upon it?

**MR WHITE:** In principle, yes, I believe so.

**MR HARRIS:** And the question from your point of view then, noting that you've caveated it with "in principle", is that perhaps in a practical effect some of the ways that the future of financial advice and duties were imposed placed a larger burden on smaller firms, smaller brokerages, would you be concerned about primarily that rather than - well, no, I shouldn't put words in your mouth. Tell me what your concerns are.

**MR WHITE:** Well, firstly I'm not an expert on ...(indistinct)..., so I'll need to sort of position that to one side a little bit. But as far as the banks taking ownership of certain aggregation firms versus independents, there is a group called the Combined Industry Forum that we're a part of and they're working on disclosure pieces there. And I believe that having the disclosure piece appropriately positioned is I guess one of the pieces that we use to balance the market place.

The independents, I think there is a good balance. Certainly all the smaller sizes, they're generally up to about 500 brokers, they're rarely above that and I don't know why that is, it just seems to be where it balances out. But they're all providing a service. There's arguments of pros and cons on both sides of the fence, from how that positions.

So it's probably where my thoughts are.

**MR HARRIS:** You're wary of the idea. In principle you'd support it but you're wary of its practical application.

**MR WHITE:** Yes, I guess that's not unfair.

**MR HARRIS:** Okay. No, I'm just more trying to find out - because we have a recommendation in one case and an uncertainty in the other.

**MR WHITE:** Both are providing great services in the market, but the things we've got to watch is the vertical integration piece, the white labelling of products, to make sure that those are appropriately balanced and not misaligned.

**MR HARRIS:** And clarified, yes. No, I don't think - again, we're on reasonably common ground with white labelling. This question here is one where - how much confidence can you have when there isn't a duty of care? It's almost like the reverse, trying to prove that you are compliant in all respects.

Anyway, we can - do you want to do more on duty of care?


© C'wlth of Australia

**DR KING:** Yes. Well, following on from that, because you mentioned the white labelled products. It has been put to us that there's various vertically integrated broker models, there's various, for want of a better word, kickbacks, benefits brokers can achieve, incentives in place for brokers to provide the internal products. Are you aware of those, and so are you able to enlighten us further?

**MR WHITE:** Yes, sure. As far as those sort of products, some of it was actually only to the aggregator, not the broker, and some was directed to brokers. Most of those have already stopped, all right, and that was part of what's come out of the ASIC Remuneration Review from 2016 and various things that industry has done through the Combined Industry Forum to take steps to enhance better consumer outcomes.

So there were promotions, years ago now. So it's not current. But it stopped a couple of years ago, where banks would promote directly to brokers saying, "Hey, look, every loan you give us we'll give you an extra two grand" - hypothetical. And then there are other incentives that were then separate to that, that were more total volume driven that would go back to the aggregator. But again, these too have stopped, or have stopped in the main. Because obviously that is providing or risking a poor outcome.

**DR KING:** Are you aware of, within the vertically integrated aggregators, whether there are perhaps less obvious incentives given? I mean, the two that you mentioned are very obvious ones.

**MR WHITE:** Well, there's obviously sponsorships of conferences and things like that that transpire. And the industry is looking to resolve those to make sure that (1) that industry when they're holding conferences are 80 per cent or more of educational content, they're not just junkets as such, that location is appropriate for what they're doing as well.

And many lenders have - well, that integration piece have gotten behind those and swayed them. But again, these things are things that are historic, not necessarily today. It's always difficult to see what you can't see. So I don't believe in the current environment there is more than what we can see, or not much more than what we can see.

The past is something that I'd be more questionable over, but since the NCCP, so from 2010, and also where we are today, these things have definitely lifted the game, and rightly so.

**DR KING:** Do brokers working for integrated aggregators ever get pressure if they're not writing enough loans, enough in inverted commas, that relate to the owner of the - or the large shareholder?

**MR WHITE:** Not that I'm aware of, but I can't say that that would be a possibility.


© C'wlth of Australia

**MR HARRIS:** Do you think that brokers that work for - in a bank-owned entity are obliged at all to inform the consumer that they're negotiating effectively with their employer?

**MR WHITE:** There is disclosure pieces that need to be put in the credit guide that talks about that, and it's also being more ramped up through what the forum's been doing in the marketplace, so industry is pushing that out further to ensure that it is very, very clearly stated.

But it's interesting when you look at that, that in the majority of sectors, I won't say it's all but in the majority of sectors, that doesn't actually come into the actual discussions. Brokers in general, and I'm only talking in general, work in the best interests of the client. It's like anything, you know, there's always a small percentage that will do something wrong, and that doesn't necessarily meant it's systemic within the industry or the industry is bad.

**MR HARRIS:** I wasn't so much thinking of them even doing something wrong, as making - - -

**MR WHITE:** Decisions in that direction.

**MR HARRIS:** - - - the customer aware of the conflict that they themselves must face. I mean, effectively a broker going in to negotiate a loan if they're acting in the customer's best interest is effectively saying to that customer, "Now, I'm going to go into the next room and negotiate with my employer on your behalf".

Even if the employment arrangement is somewhat broken up by a contractual obligation and God knows what else, it doesn't matter. That's actually what we're sort of relying upon here, and at its very least, you would imagine, that that disclosure would need to be made, not just so much in a, you know, here's a bunch of papers and please tick the box basis, but you would think it would be a very important upfront kind of recognition thing, if only to establish trust.

**MR WHITE:** No, I agree. And it's - what I always talk about is truth through transparency. That transparency gives you the trust. Completely agree. But initially what was transpired was a disclosure piece in the NCCP through the credit guide, and industry is now ramping that up to make it far more transparent.

**MR HARRIS:** And you're confident they will succeed with this kind of process?

**MR WHITE:** I'm confident they will, it is something that is being worked on. But most certainly I'm confident. And our research into - or the industry's research into the market place sees that there is no barrier to doing that, no one sees it as a problematic thing. Industry sees it as an easy thing to do.


© C'wlth of Australia

**MS ABRAMSON:** Peter, can I ask you, you said it a few times and I understood what you said about best interests. So are you saying that in practice, even though the legal test is not unsuitable, that brokers in your experience - we're talking about the majority, not the small minority - are actually looking at the broader suite of products because they're looking at what's in the best interests of the client?

So would that mean that in practice you wouldn't expect much change in the nature of how people go about doing their job?

**MR WHITE:** That's correct. And also too, a lot of this is technology-driven. So when we talk about what is the selection in front of the borrower, potential loan options, they come off a computer system. It's not in the old days where it was manual hard labour to try and extract what was what. So the computer system - - -

**MS ABRAMSON:** That's why we're interested in integration though, what products are put before the customer.

**MR WHITE:** Yes. It's generated off the aggregator's loan system, management system, and that creates a suite based on the parameters of what the borrower's looking at the inputs and fields and so on, I guess to that. Where he says, well, here is a selection of things that unfortunately not unsuitable for your needs, and then there's recommendations and discussions happen from there.

**MR HARRIS:** And on white label loans, to the best of your knowledge, being an expert in the industry, is the same broker obliged to take the same disclosure process if the loan he or she comes back with to the customer is a white label loan, "I'm recommending you go with this white label loan", are they equally obliged to say to the customer, "But be aware, this loan is effectively being sourced from, again, my employer"? Is it clear?

**MR WHITE:** Probably not in those words.

**MR HARRIS:** Well, you know what I mean.

**MR WHITE:** Yes, it is. They must be obliged to do that.

**MR HARRIS:** You see it's like it almost looks like an impossibly unlikely situation for this to occur, is I guess the reason we're doubtful about it. It just seems so unlikely that a party will say, "I've gone very carefully to strip away the identifiers on this loan", to white label it, "to provide a different identifier, in order to sell it to you, but I'm still going to disclose that it's my owner".

**MR WHITE:** It has no material impact to the transaction in as far as what is a better option. The most appropriate options are whatever they are, that are not unsuitable. So if the lender's white label product happens to be that, then yes, they need to reinforce that this product is, if you like, for sake of a better term, their employer's product as such, or their


© C'wlth of Australia

owner's product. That's something the industry is saying that it should be done. But if it's not, it's not. And it's very transparent that it's not.

At the end of the day, what we've got to realise is home loans are fairly commoditised. There's some cases there's not a lot of difference between what may be selected as options.

**MR HARRIS:** I've got to go through my list, so you do that while I go through my list.

**DR KING:** Yes, so one of the areas we've asked for more information on is whether financial advisors should be able to move into offering home loans, apart from just mortgage brokers, so direct competition between the two. Do you have any comments on that?

**MR WHITE:** They already can. This was a large discussion back in - was it around 2009 I think it was - sitting at the table when we were working with Treasury to bring the NCCP in. Financial planners wanted just carte blanche, get a free ticket, and that was argued against because credit was something different again, it's another skill set, and there were components they were given credit for as such.

But financial planners have been doing it forever and a day, providing home loans. And in the analysis of some of the data I have here, you'll see that although the broker ACLs, for just an example, is 21,000-odd, the actual total ACL market is significantly more than that.

**MS ABRAMSON:** Peter, can I ask you - - -

**MR WHITE:** It's actually up around 39,000.

**MS ABRAMSON:** Could I please ask you a question about that? How can a financial - it might be my ignorance, how can a financial planner provide advice and offer a home loan without having a credit licence?

**MR WHITE:** They can't - well, they need to be a credit rep, and there are many, many credit reps - - -

**MS ABRAMSON:** No, I understand that. But at the moment in our system, when you say they can, because it's one of the other things that we're thinking about, they need to have the dual licence to do so.

**MR WHITE:** Well, no, as a financial planner, they could also be a credit representative, they don't necessarily have to hold the licence.

**MS ABRAMSON:** I'm sorry; we're on the same page.

**MR WHITE:** And there has been since the beginning. This is where there's disparity of numbers between those who are actually identified in ASIC's data as brokers versus the total.


© C'wlth of Australia

**MS ABRAMSON:** Actually, it's interesting, do you have an anecdotal - you gave us some figures before, I'm really interested in these, the number of people with a wealth management licence, for want of a better word, who also have a credit licence.

**MR WHITE:** No, we don't have that data. And I think ASIC may struggle to do that as well.

**MR HARRIS:** We've been to the official sources already. We were just hoping you might have - - -

**MR WHITE:** I've been doing a lot of digging on that data and I sort of know where the line gets a bit fuzzy. But look, anecdotally, planners have been doing this for a long time. When I was in private banking, a large part of that was also a financial planning wheel, not that I was part of that division. But that crossover as such has been there for a long time. But they would hold a credit representative status in the marketplace to be able to do so by law, on consumer debt.

**MS ABRAMSON:** Because one of the things we've sort of put out there and thinking about is whether there could be a mechanism that you wouldn't have to have the credit rep part of a financial licence and whether something could be done in that context.

**MR WHITE:** I would be concerned with that. I mean, it's a different skill set. There is credit already given to financial planners, I mean, as far as I'm concerned, they have a higher knowledge from my point, but their knowledge isn't in credit, it isn't in lending, and it isn't in consumer law in regards to lending. So that knowledge has to be framed and understood.

So I don't think it can be a free ticket as such, and basically it is what happens today, is that there's a certain amount of credit for a certain amount of knowledge, then you have to do this piece, then you become a credit rep, or whatever the case may be, some hold licences.

**MR HARRIS:** Can you explain to me, I'm sure this will be within your expertise; it goes to actually how the business is conducted at the coal face. With such a relatively large upfront payment that a broker gets with a loan, I mean, it's a biggish chunk of money, why do we not see some brokerages offering some rebates of that to attract customers? In other words, why don't we see cut price brokerage? Is it a contractual obligation? Is it the industry is on such incredibly fine margins that no one could ever be expected to do that without going broke? What's the reason?

**MR WHITE:** I guess the first thing I can say is I guess we talk about relatively large upfronts, my question is relative to what? To financial planning it's not, it's significantly less. And what you've got to remember is it's a cost to do business, it's not like a broker sits down with one client and writes the loan for that client. They may see 10 different clients before they get the right to write one.


© C'wlth of Australia

So there's that cost of time and the cost of marketing and advertising and what goes with it. But that rebate model used to exist: there was a company called Refund Home Loans in the past. It collapsed, for various reasons. But the model, depending on I guess how you price it, isn't sustainable because of the actual cost to do business.

Now, the average broker, once you take away the business cost, the actual cost to conduct business, might only be on $70-$75,000 a year. They don't make huge money. And they're small mum and dad business operators, a lot of them operating from home, some of them from small offices with staff networks, and yes, there are some at the big end of town as well. It's a different animal again.

But the rebate model is very difficult, because at the end of the day they actually don't make huge money, overall. It's not like a broker does 10 loans every month. They probably do somewhere between - settle two or three loans every months. Sometimes more for some, but not in the vast majority.

**MR HARRIS:** My "relatively large" was relative to any alternative system, although we have been given different advice on wealth than you - the numbers you've put forward today, but I'm not able to dispute them.

**MR WHITE:** My wealth numbers comes from the industry this morning.

**MR HARRIS:** Yes. I'm not able to dispute that. As much as anything, because apparently there is a huge differentiation there about charging, so I'm told. Anyway, let's leave that to one side. No, it was more if the payment to a mortgage broker was $500 upfront, and then, I don't know, $1,000 a year for every year that the loan's in operation, I would say there's very little chance of sharing much of that upfront with the customer. But if it's $3,000 upfront there's more chance of sharing it if indeed competition is strong in the industry with brokerages trying to cut each other's throats.

**MR WHITE:** Assuming their overheads makes it available.

**MR HARRIS:** Well, that's right, unless you're going to go broke, in which case - - -

**MR WHITE:** Yes. There are many, many brokerages that actually give back to their communities by way of charity donations and so on as well. So it's not like they sort of pocket big wads of money and don't do anything, they're very community-minded at the same time.

**DR KING:** Are you aware of any of the banks that explicitly require that any part of the payment to the broker is not handed back? The reason of course is that ANZ obviously won a court case a few years ago saying that they were allowed to do that with their mobile - - -

**MR WHITE:** With their mobile lender franchise.


© C'wlth of Australia

**DR KING:** Yes. So are you aware of anywhere - - -

**MR WHITE:** In the broker space I'm not aware within the contracts that there is a restriction for doing that. I may not be correct though, that's just my understanding.

**MR HARRIS:** Are these contracts the sorts of documents that when you ask for them you would expect would be made available?

**MR WHITE:** I couldn't see why not, unless there was a legal reason.

**MR HARRIS:** Yes. We struggle to see that too. Can we do LMI, are we able to get to end of fundamental likely agreement? You have put forward a proposition on LMI that the costs should be disclosed upfront as part of the agreement. Our recommendation was, knowing that in the past efforts have been made to look for some refund, this is an insurance product, obviously if the insurance products are fully used in other insurance products there is a refund, but that it failed in the past because of supposed complexity.

So we look at it and thought, well, why can't it be specified up front. In other words, if the loan - your LMI is for the first three years of you loan, if the loan goes beyond three years you don't get a rebate, the customer that is, if the loan is renegotiated or if your loan to valuation ratio improves sufficiently for you to no longer need the LMI. But where those other two circumstances have changed, you should get some form of repayment of the, again, a largish number, in the case of most LMI payments, you should get some of that back.

What did you think about the recommendation if made, for setting it upfront?

**MR WHITE:** Yes. It's a debate that I've had with the insurers over quite a protracted period of time, which was all in the public circles as such and they're not happy about it. But even as of the last week and a half, speaking to one of the insurers, the discussion on any sort of rebate, they believe would increase the cost of premiums, so disadvantage products.

I don't necessarily agree with that. I look at it in very simplistic viewpoints, this simplistic person. If I get a car, I get insurance, I pay it out early, I get something back because it hasn't gone full channel. If the LMI's business models are so stressed on their need to retain all incomes with no margin in it, I have certain questions over that as well. I believe there should be a rebate component, and there is under the credit policies. The problem is the credit policies are very restrictive.

One of the restrictions in the credit policies is if you want a rebate you've got to apply for it, if you're eligible for it, within 30 days. And that means you've actually got to go through the existing lender to get that rebate, who you've just gone and discharged a mortgage from who is not your friend any more. So chances of doing something in 30 days are very, very limited.


© C'wlth of Australia

Then they also talk about there can be no credit impairment, but it's not defined what that may be. So you might have been late for one month and all of a sudden they treat that an impairment issue and therefore you're ineligible. There's lots of other things that need to be concerned, but in the principle of the rebate, yes, I am very supportive of it.

Same with portability, they argue that the problem with portability is the risk dynamics between different lenders. So it's not just the profiling of risk for the borrower and the asset, it's also the different lenders. I would have thought today's technology and knowing I used to process LMI manually back in many moons ago, technology would make that rather simple.

**MR HARRIS:** Particularly if you establish the characteristics of the insurance as we've described upfront.

**MR WHITE:** Yes, they do.

**MR HARRIS:** The last three years or whatever the term is, if circumstances change or the loan is repaid within that period you get a chunk back. Seems a pretty simple kind of reconstruction, and I assume lenders mortgage insurers, if they were to say that premiums would rise, would be able to justify that against some claims experience as well.

**MR WHITE:** One would assume.

**MR HARRIS:** Which is information that we will probably be seeking from them and from the banks, because this has become quite an area of possible interest. Tell me, do you think a broker, being paid a trailing commission then by a bank to manage the customer, if that customer was a customer that obviously the broker would know, a customer that paid LMI, do you think it would be a reasonable expectation for that broker to advise the customer that they should be able to seek a refund of the LMI?

**MR WHITE:** Unquestionably so, yes. Yes, most certainly. The problem is is that the market place really doesn't know the parameters in which that revolves.

**MR HARRIS:** And one of the few parties that might have a better understanding is actually the broker themselves.

**MR WHITE:** Yes.

**MR HARRIS:** All right, I'm done.

**MS ABRAMSON:** I had one question, I'm sorry, Peter, I'm taking you back to something you said before. I do understand the difference between credit and wealth management, but I'm just interested, you made a comment where you said, "Oh, but they're different products", but your home loan could be the biggest financial product that any individual takes out. So why do you think that the obligations or the understanding of credit is so different from a wealth management product?


© C'wlth of Australia

**MR WHITE:** Well, there's different laws and different premise that apply.

**MS ABRAMSON:** I know that.

**MR WHITE:** So just because you're very good at wealth management, doesn't mean that you understand the premise of lending and credit, and vice versa obviously of course. So that's why I said it was different.

**MS ABRAMSON:** Thinking about it from a product point of view, I know the legal regimes are different, I understand that, but what's so different about the nature of the products? I'm not talking about super, I'm talking about a home loan perhaps versus a managed investment which could be also in a real estate vehicle.

**MR WHITE:** In simple terms, one's debts, one's investment. So they're two sides of the coin to start with. Also too, I guess the laws that revolve around credit are very different - or are different, I should say, to the laws that revolve around investment. So there's different knowledge sets.

As I said as well, there are many crossovers and there is - for example, we have credited knowledge given to a certain component, but there's still a piece that needs to be filled in. So just an arbitrary blanket across it, to me, I'd think would be a challenge, only because of that little piece that sits there that needs to be known and understood.

**MS ABRAMSON:** I understand.

**MR HARRIS:** Done?

**DR KING:** Yes.

**MR HARRIS:** Peter, thank you very much for making the time and effort and for being one of the few people who has turned up here with data, so we want to give gold stars for anybody who comes with data.

**MS ABRAMSON:** Indeed. The team are running towards Peter.

**MR WHITE:** I came prepared, and our index will be available shortly, to have it today.

**MR HARRIS:** We might need to come back and ask you some questions about data too, so hopefully we'll be - - -

**MR WHITE:** Certainly, my pleasure.

**MR HARRIS:** Thanks very much.

Okay, Maria Rigoni; Maria, come on down. You're one of our right at the start submitters; I


© C'wlth of Australia

remember your submission. It was short, so we've got a positive view of short submissions: you know, "Oh, I'll read this one tonight," you know?

Sorry, could you identify yourself please, for the record?

**MS RIGONI:** I'm Maria Rigoni, I'm a mortgage broker.

**MR HARRIS:** Do you have some remarks you'd like to make?

**MS RIGONI:** Yes, I do. I hold a Bachelor of Business qualification, with management and psychology, majors in management and psychology, obtained through Swinburne University, and the required mortgage broker qualifications.

I was a full-time employee of the Commonwealth Bank for most of the period between 1970 to 1997. My company, Universal Wealth Management, has been a master agent member of Australian Finance Group Aggregation since 2001. I have obtained residential and commercial lender accreditations to introduce loan business to many, many lenders since 2001, including some who no longer exist. Most of the lenders have been on AFG's panel of lenders, but some have not been.

Mortgage broking: a product sale is between a buyer and a seller; I'm sure you know that. A competitive market place needs buyers who are seeking a solution to a need; buyers who are eligible to make a purchase; buyers who have financial ability to purchase; and buyers who can authorise a legitimate purchase, together with the product manufacturer/seller, who is able to satisfy the solutions sought by the buyers.

Mortgage brokers are not agents for, or employees of, credit providers or aggregators. Mortgage brokers have no authority to approve or refuse any credit provided loan. Mortgage brokers have no authority to accept or reject the lender loan contract proposed for the borrower.

The sale of a mortgage broker's service - which is our product - with a potential borrower - who is our buyer - occurs well before the separate sale by the lender of a loan - which is their product - to a borrower - their buyer.

The sale of a lender product launches at the point the lender receives for assessment a signed lending proposal from the potential borrower; the sale concludes at the funding settlement of the loan. The remuneration paid by credit providers directly to aggregators and indirectly to mortgage brokers is not paid by the clients, per se; it is paid from the credit providers' gross business revenue and is a tax-deductible business expense.

Mortgage brokers, mostly, do not have remuneration contracts in place with credit providers; mortgage brokers are indirectly remunerated by the lender via the aggregator, for the pre-qualification initiation of new-to-lender business, submitted for assessment and approval by the lender or the mortgage insurer, and accepted by the borrower.

Aggregators have **- - -**


© C'wlth of Australia

**MR HARRIS:** Well, thank the Lord for that, all safe.

**MS RIGONI:** Is that the first time we've had the - - -

**MR HARRIS:** We've never had it in my experience; five years, I've never had it. Sorry Maria, please go on.

**MS RIGONI:** That's all right. Mortgage brokers are commissioned by aggregators to track down and pre-qualify people who lenders on their panel may want to engage in a credit contract with, and then to submit the loan proposal directly to the lender for credit decisioning, using unique aggregator mortgage broker identification numbers and software.

Aggregators have access to all credit policy and credit product information for all lenders on their panel. Via individual lender accreditation, mortgage brokers are authorised by credit providers to have access to their specific lending credit policy; capacity to repay calculators; valuation gateway; supporting documentation checklist; assessment criteria; credit product information; interest rates and fees; loan scenario hotlines; online application gateway; and application progress tracking.

A mortgage broker client is a potential borrower seeking assistance in finding a solution to a desire for credit. Mortgage brokers are commissioned by potential borrowers to facilitate access to not unsuitable finance options. Sometimes, there may be no options or only one option; sometimes, there will be many options to consider.

A mortgage broker's business is often confused with mortgage management or white label, as many people call it. A broker business, and the roles and functions in the marketplace are vastly different. Mortgage brokers introduce pre-qualified loan proposals, with supporting documentation, to a lender; if the lender and the borrowers commit to a loan contract and the loan is funded, the mortgage broker is not directly involved in the lender/borrower relationship, nor responsible for any ongoing management of the performance of the loan account.

A mortgage broker business is in competition with every bank and mortgage manager in the marketplace for potential borrowers, not so that they can sell a loan product, rather that they can sell a mortgage broking service: a no cost to borrower service that obtains broad possible lender solutions for individual borrower requirements. A mortgage broker is a valuable consumer outcome that is a missed opportunity if the potential borrower goes directly to the credit provider.

I could go on, but, you know, that's probably enough.

**MR HARRIS:** No, it's an interesting description of the relationship. Can I ask you then: in the latter part of what you just said, you actually indicated that if a loan is funded, the agreement is between the borrower and the financial institution, and the broker, you said, has no ongoing management relationship.

**MS RIGONI:** That's correct.


© C'wlth of Australia

**MR HARRIS:** Now, we've had it put to us, including I think by Peter White - not so much what he said here today but in some other public comments he's made - that the fact - the reason the banks pay trailing commissions is for two purposes. Now, Peter has dissociated himself from churn and what he said today but certainly in terms of an ongoing management relationship, that appeared to be the rationale for paying trailing commissions. From what you've said, perhaps it's not quite as black and white as that?

**MS RIGONI:** It's not as black and white as that, and I have never ever been asked to sign anything or seen anything that tells me that I am responsible for that type of thing.

A few years ago, CBA tried to bring in this thing that if a customer's loan went into arrears, that they would contact the broker and the broker could ring the client and find out what was going on, et cetera, et cetera, et cetera. That was an optional thing, and from my perspective I chose not to do it. And I think what is trying to be forced upon the broking industry at the moment is that that becomes an additional part of what we do, and I think that individual brokers, small businesses, are being taken unfair advantage of through the accreditation system, and - look, we have relationships with our customers, ongoing.

And I've had an instance twice over the last couple of days: one on Friday night and one yesterday actually, where clients have contacted me and said, "I've received this email from my bank Maria, I don't understand it. Can you explain what it's about?" Right? I have no problem, that's part of my role because I introduced that client to that; they are unsure of what's going on, please ask me. Right?

So, from that perspective. But the idea of you get an upfront payment and an upfront payment is not really an upfront payment until the end of the clawback period, because it can be taken back at any time within up to - usually a hundred per cent within 12 months and then 50 per cent for up to another 12 months.

And for me, the clawback is the transference of commercial risk from the lender to the broker; it's clear-cut. And because we have no negotiation right in any remuneration contract, we're left sitting there. And when you look at bank-owned aggregators, the bank is negotiating a remuneration contract with themselves that affects all brokers that are signed up to that aggregator. So, how do you survive?

And with clawback, I can give you an example of a clawback recently that I've seen, where one broker did a loan for a consumer, for a legitimate reason; the consumer didn't want to stay with that lender because the lender couldn't provide them what they wanted, so they moved to a new broker and lender.

**DR KING:** After how much time, sorry?

**MS RIGONI:** After eight months, so the first broker was clawed back 100 per cent.

The second loan was in place and it was a two-tiered loan, where it was a refinance and a construction thing. In the end, after the business had been moved across, the lender decided that they did not want to do the second part that had been pre-approved, which is their right;


© C'wlth of Australia

they have every right to do that. So, that was eight months or seven months in position, so that broker is clawed-back 100 per cent of the upfront. So, then the borrower goes through it, because the borrower has gone to another lender.

With the new lender, the 18-month clawback position starts again, so it's not something that's isolated or anything, it's got nothing to do with what the broker does, whether the broker does a good job, a bad job or anything; it depends on what the borrower decides to do after they've contracted with the lender.

**DR KING:** If I put a bank's hat on though, I'd say, "Well, surely, it's part of the broker's job to make sure that the product that I'm offering as a bank - - -

**MS RIGONI:** Yes.

**DR KING:** - - - is a product that really meets that consumer's needs so that there is a very low likelihood that within the first two years, they're going to want to move on to another product."

**MS RIGONI:** Well, that's if you are fully aware of everything that's going to happen with that borrower, for the next two years, which you don't know; their circumstances can change. They might decide to do one thing and the lender only has an appetite for this and not that, so the consumer has no option if they want to satisfy their finance needs, to move to a different lender.

**DR KING:** Yes, I guess I'm just thinking, isn't there a bit of a role - you know, yes, there are things that can change for the consumer, but isn't there a bit of a role there for mortgage brokers? I mean, it may not be the degree of clawback, but isn't some clawback sensible, you know, from the bank's perspective, to make sure the broker is sending the right clients in their direction?

**MS RIGONI:** But the lender gets all the information about the borrower at the time, and the decision is made by the lender whether to approve that loan or not approve that loan, and then the borrower has the option to either accept that credit or refuse that credit.

**DR KING:** Yes, the broker doesn't have a decision.

**MS RIGONI:** The broker doesn't have any say in it; we're just doing what two parties have brought us together to do.

**DR KING:** Yes.

**MR HARRIS:** Sorry, I just want to stick on clawback, then. So, in your view, clawback is still quite a common element of arrangements?

**MS RIGONI:** Yes. And it also can put a broker into a position of insolvency.

**MS ABRAMSON:** That's what I was going to ask you.


© C'wlth of Australia

**MS RIGONI:** If they get a few clawbacks, because you've got no idea when these clawbacks are going to go, and you can actually be clawed back before you're paid the commission on the next deal.

**MR HARRIS:** Yes, but they're common. Because there have been different suggestions that they're being phased out or adaptations anyway that make them less of an anti-competitive device; that doesn't seem to be the case from your own experience, anyway?

**MS RIGONI:** Well, no, I think clawbacks are very real, and sometimes you might not get a clawback for 12 months, 18 months, but you don't know when they're coming, so the upfront commission is like a loan, you know, to help you run your business or something, and then it can be taken back at any time.

**MS ABRAMSON:** That was actually what I was going to ask you then. We had some evidence today that a number of brokers of small business, one or two people operations, how it is that you can provision for that, for the unknown unknown?

**MR HARRIS:** We were also told about these codes of conduct inside the industry, you know, collectively the industry has been working on combined industry forums and things like that. In your experience, are these - I mean, do you face competition from people who are probably less - how can I put it - attached to concepts of you know, good practice working on behalf of the customer and that sort of thing?

**MS RIGONI:** I am not a member of either industry body.

**MR HARRIS:** Right.

**MS RIGONI:** And in saying that publicly, I could lose accreditation because lenders can say, "Oh, you're not a member of those bodies and we want you to be, for accreditation purposes."

**MR HARRIS:** I think it's an offence to cause an action like that against people who give evidence to the Productivity Commission. I think I'll just note that for the record, thank you.

**MS RIGONI:** I was a member of the MFAA for ten years, and I was a member of the FBAA for a number of years; I was actually on the Victorian committee for the FBAA. And I just didn't think that the FBAA - I think they're very conflicted, the industry bodies, in that they are reliant on members, for accreditation purposes, must be a member of both of those - one or either of those - industry bodies.

I can't get accreditations with certain lenders that have come into the market because they say to me, "No, you're not a member, so therefore we will not accredit you," and I say, "Well, why would you not accredit a broker to introduce new business to you?" If a consumer comes to me and I know that that's the best product for that particular client, what do I have to say as a broker? I have to turn around and say, "Oh, I'm sorry, I can't do this for you because that lender is not going to accredit me because I'm not a member of one of those two industry bodies. I have an Australian credit licence, but that's not good enough to have an accreditation, so therefore you have to go into the market place and find a broker that does have an


© C'wlth of Australia

accreditation with that lender, or you must go directly to the lender yourself."

**MS ABRAMSON:** Can I just ask - I might have misunderstood this - it's a related question to what you said: your accreditation with one of the industry associations, you can independently belong to CIO, you don't need to go through your broker association to have your dispute resolution, which is a requirement of the licence.

**MS RIGONI:** The legal - yes?

**MS ABRAMSON:** Yes. You can do it independently, yes.

**MS RIGONI:** Yes. I have to be a member of the credit ombudsman.

**MS ABRAMSON:** Yes.

**MS RIGONI:** Yes.

**MR HARRIS:** All right, other questions?

**MS RIGONI:** You've asked a few questions during the hearing about LMI.

**MR HARRIS:** Yes. Julie, do you want LMI?

**MS ABRAMSON:** I certainly - - -

**MR HARRIS:** All right, from our - - -

**MS RIGONI:** LMI is not an insurance policy that a borrower can purchase; that's something that really needs to be understood. It is an insurance policy between a lender and a mortgage insurance provider, okay? So, with the things with rebates, it used to be reasonably common for people to have a rebate; I don't think any of the major banks have rebates anymore. And there was something said that, that's because they negotiated a cheaper policy, so it got rid of the rebate.

My concern with mortgage insurance is the premiums and how they're calculated and the loan to value ratios, and how they're divided up into zero to 300,000; 301,000 to 500,000; 501,000 to 1 million; and over a million. And they're divided individually from LBR, basically 1 or 2 per cent, going up.

So, a borrower can borrow say, 500K at a 94 per cent LBR and it'll be 2.8 or 3 per cent; if they borrow $500,001, the premium goes up to 3.91. So, for borrowing one extra dollar, there's a huge increase in premium price, and I don't understand the rationale for that, and I don't believe that that is explained to consumers, and it can cost them a lot more in mortgage insurance premiums just by borrowing very little extra.

**MR HARRIS:** And do you think they're relying upon the brokerage industry to tell a customer that?


© C'wlth of Australia

**MS RIGONI:** Well, quite often we don't know what the exact premium is until the loan documents are issued, or the approval is put in place.

**MR HARRIS:** But wouldn't you be - - -

**DR KING:** In your experience, after a couple of years, you'd - - -

**MS RIGONI:** We can calculate it, we can calculate it even on the aggregator's product comparison software; there's usually a mortgage insurance figure there, but it's not always what they're charged.

**MR HARRIS:** No, okay.

**DR KING:** In that situation, so, I've come to you and said, "Look, I need a $505,000 loan," and you do the calculation and on the calculation on the interface you've got the quote and you say, "The LMI looks a bit high. If you bring it down to 500 or 499, you - - -

**MS RIGONI:** Yes, I'd work it out.

**DR KING: - - -** would offer that price, yes.

**MS RIGONI:** I'd work it out, yes. Yes.

**MR HARRIS:** Yes, well LMI is an area of increasing interest I think would be the right way to characterise it, if we can get some data.

**MS RIGONI:** Yes.

**DR KING:** Can I just - I like the way you actually characterised working in the industry at the beginning; I wrote down a little bit here, I said, "introduction agency" which is sort of how I get your characterisation. It is, you're talking to clients, you understand the client's need, say, "Now, here is the product. Okay, I think this is the best product for you," that's what you get paid for, that expertise.

**MS RIGONI:** Yes.

**DR KING:** Then you help the client put in the paperwork, and it's arguable whether, you know, should the client pay for that our should the bank pay for that, you know, because you're saving the bank time and effort for that. That's all fine.

It's that trail commission paid by the bank I really have trouble understanding. I mean, the same way I don't understand - and I think you explained the clawback very well, and the issues associated with that and the fact that it's something outside the broker's hands. I mean, it's like these: we've been told, "Oh, it's a payment for ongoing management of the customer," but it's paid by - - -


© C'wlth of Australia

**MS RIGONI:** See, I don't believe that.

**DR KING: - - -** the bank - yes.

**MS RIGONI:** See, I don't believe that; I believe that it's paid as part of the introduction of the new business; it's paid as a, "This is your payment for introducing this business to us." And when you restructure a loan for an existing client, you don't get any upfront, but you will get the ongoing trail; so, that loan, you don't get any upfront but that loan becomes part of your portfolio, okay?

And that portfolio and the little dribbles of trail you get from each one of those loans in your portfolio, becomes a saleable part of your business.

**MR HARRIS:** Yes. No, we understand all of that.

**DR KING:** Yes.

**MR HARRIS:** We asked and we received this claims rationale that it was driven by desire for a bank - - -

**MS RIGONI:** I believe that the Combined Industry Forum - - -

**MR HARRIS:** - - - to see it re-managed. Now, I could point out the link between Stephen's question and something you said earlier.

**MS RIGONI:** Yes.

**MR HARRIS:** The Commonwealth Bank believes that if a loan looks like it's going sour, you, the broker, probably should do something about it. Well, that's a saving of staff time to the Commonwealth Bank, and I could see the Commonwealth Bank going, "Yes, we should get brokers to do all the hard work in this area."

**MS RIGONI:** That's right.

**MR HARRIS:** And I could see that rationale being used. But you're saying from a broker's perspective, "That wouldn't traditionally be considered part of our job?"

**MS RIGONI:** No, and it wasn't. When I first came into broking in 2001, we used to find the clients, fill in an application form, collect the supporting documents and fax it off to the lender, and that would be the end of what we had to do, you know? We didn't have to order valuations; we didn't have to do the data entry; we didn't have to follow everything to make sure everything moves over. If we don't follow everything these days, the loan just doesn't move. And - I think I've lost my train of thought, there.

**MR HARRIS:** Ongoing management responsibility, yes.

**MS RIGONI:** Yes, and if you're really honest about all of this, when I came into broking,


© C'wlth of Australia

NAB and CBA would not allow us to introduce business to them, okay? So, the upfront and trail payments were in place then; it was later on - - -

**MR HARRIS:** I see your point. So, even though the payments were there, you weren't able to do this.

**MS RIGONI:** Yes, and even - - -

**MR HARRIS:** So, that couldn't be a rationale.

**MS RIGONI:** Even that, a couple of weeks ago a client rang me and said, "Maria, the address on my statement is still going to my old home," and I rang the lender and said, you know, "You haven't changed the address," and they said, "Well, we're not supposed to be talking to you about this client because the client hasn't signed a Privacy Act form."

So, how am I responsible for what happens to the loan? You know, I am not the loan processing centre for the banks; I am a person that my aggregator has commissioned me to go and find clients that lenders on their panel want to lend money to - - -

**MR HARRIS:** Yes.

**MS RIGONI:** - - - and the borrower wants to accept.

**MS ABRAMSON:** A number of witnesses have said to us previously, or at least in meetings, that the banks do their own due diligence on the loans.

**MS RIGONI:** So, annual reviews and all the rest of it. I mean, yes. And a lot of clients - I mean, sometimes a client will ring you about something or ask you about something and you find out what their interest rate is and you say to them, "Look, that interest rate is getting a bit pricey, do you want me to look at what else is in the market?" " Oh no, it's okay. Leave it, I'm quite happy where I am." So, I can suggest and recommend.

Some of the other things that you were asking about are comparative rates?

**MR HARRIS:** Comparison rates.

**MS RIGONI:** Comparison rates.

**MR HARRIS:** Yes.

**MS RIGONI:** Comparison rates were useless when they brought them in, and they're still useless now.

**MR HARRIS:** Oh, hallelujah. Hallelujah.

**MS RIGONI:** Comparison rates; and what they've done is, one of the fees that was included in the comparison rate was application fees, and you'll find now that most lenders don't charge


© C'wlth of Australia

an application fee because that affects the comparison rate.

**MR HARRIS:** Yes. You know, we've been told that these - I was calling in to somebody the other day; they are ghost policies: they were considered good once, and they keep going on like ghost nets do, drifting around the fishing grounds because no-one's there to pick them up and put them in, and take them away.

**MS RIGONI:** Yes. And you know what would be handy for clients, if you really want them to be aware of what their interest rate is on their home loan is, the first thing you see when you open up a loan statement is their interest rate in big, bold - - -

**MR HARRIS:** But otherwise, normally you have to go looking for it.

**MS RIGONI:** Go looking in the middle for it.

**MR HARRIS:** And on the electronic sites, it's often about three or four pages, separated, and you can't backtrack on an electronic site without losing the link and having to log in again. Oh, it's very interesting. Anyway, we're not sure we can solve all of that, but thank you for making that particular comment.

**MS RIGONI:** Yes. And I'll just say, that soft dollar thing they all go on about, soft dollar benefits of brokers being wined and dined and whatever; that's not necessarily true. And even if you're an accredited broker, you don't always get invited to what the lenders, like their professional development days and things like that; they select different brokers to invite to those things, so it's not an across the board thing that all brokers are trained by that particular lender about updates and that. You might get an email, but you don't necessarily go to the training day.

**DR KING:** So, are these training days effectively rewards that they give, or you know, to run parallel in the medicine industry, it's well known that a few years ago pharmaceutical companies often used to offer educational programs on nice places like Hayman Island; is that what we're talking about here, or?

**MS RIGONI:** No, no, no, I'm talking about just recently, a lender in one of the lender magazines they said they were doing PD days and I thought, "I didn't get an invite," so I sent a message to my BDM, "I didn't get an invite." "Oh no, that's only for our gold and platinum brokers, you don't get one." So, if they were really fair dinkum about training and making sure brokers were up to speed - - -

**MR HARRIS:** They'd train everyone.

**MS RIGONI:** - - - they'd train everyone.

**MR HARRIS:** They'd train everyone. But if, in fact, it is a rewards system under a different name.

**MS RIGONI:** Yes. And the other thing with reward systems and the preferred broker model


© C'wlth of Australia

is that consumers - like, if I'm not one of those high volume brokers, which I'm not, I'm not a high volume broker - so if I'm not one of those high volume brokers and give a certain amount of business, my clients get sent to the end of the queue for assessment, so they might not be picked up for four days. And I say, "What has my client done to deserve that?"

And you know, I can't understand why they think that's okay under the NCCP, when they've got a general obligation to be fair, honest, and efficient.

**MR HARRIS:** We should note that for the NCCP, okay.

**MS RIGONI:** And with the Combined Industry Forum, you know, I'm going to be really blunt about this: I just believe that that's an attempt by the lenders to collude and change the broker model into something more that they want, without - like, we've already seen the standard commissions are all pretty much now the same, so where there was variation before, and - like, if a lender wanted to hone in on clients of high value, you know, they've had a loan to value ratio of 60 per cent or less, they might say, "Well, find us these clients and we'll give you an extra little bit of money."

Those sorts of things are all disappearing now, and we're just getting a standard commission down the thing. And with the trailing commissions; you talked about the incentive to stop churn. It used to be that trail was the same level, straight across the board, that was it, you know? It was either 0.22 or 0.27 and that's inclusive of GST. Since about 2008, they've changed so that you start off with a lower trail component and then it builds up after year four or year five. But that wouldn't stop a lot of brokers from moving clients if it was - - -

**MR HARRIS:** Yes.

**MS RIGONI:** - - - easy to clients.

**MR HARRIS:** You can see why that might be.

**MS RIGONI:** But we didn't introduce that, the lenders did.

**MR HARRIS:** Okay.

**MS RIGONI:** And with advice, you're talking about no advice and general advice and personal advice; that's relative to the FRSA right, but it's not relative to brokers.

**MS ABRAMSON:** We're interested in what you say, but we were very interested in that because we were looking at insurance products and financial services products other than mortgages and loans. So that's why we were quite interested, because we've received submissions that the whole term "general advice" was misleading to consumers because they think the word "advice" means it's about them, but all of us who work in the area know, personal advice is the advice that's measured to your needs.

So that's the reason we were raising it in that context. I mean, I'm interested in views on that, yes.


© C'wlth of Australia

**MS RIGONI:** I understand exactly what you're talking about, and I do think it is an issue for consumers.

**MR HARRIS:** I'd like to thank you for coming along today; your comments have been refreshing and interesting.

**MS ABRAMSON:** Thank you very much.

**MR HARRIS:** It's been very useful for us.

**MS RIGONI:** Okay, thank you.

**MR HARRIS:** Now, I think unless anybody in the room is looking to make further comments? No, there's no-one, excellent. So, we're going to suspend the hearing until tomorrow morning, where we'll start again at I don't know what hour.

**MS ABRAMSON:** It's 10 something.

**MR HARRIS:** 9.15.

**MS ABRAMSON:** No, no. Someone else just registered for that first slot, so we're here at 9.15.

**MR HARRIS:** So, we're on at 9.15 again, so we're starting tomorrow morning at 9.15, for those who want to watch us on Facebook. Okay, in the meantime, we're suspended.

**ADJOURNED AT 3.31 PM UNTIL**
**TUESDAY, 6 MARCH 2018 AT 9.15 AM**


© C'wlth of Australia