Combined Industry Forum response to the Productivity Commission's Draft Report *Competition in the Australian Financial System*

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Introduction

The Combined Industry Forum (CIF) is pleased to provide this paper in response to the Productivity Commission's (PC) Draft Report into Competition in the Australian Financial System[1] (Draft Report). We intend to provide the PC with more detail on the package of reforms that the CIF committed to in its report released in December 2017.

The CIF is working towards ensuring better consumer outcomes and improved standards of conduct and culture within the mortgage broking industry. The package of CIF reforms were developed to address the findings and recommendations by the Australian Securities & Investments Commission (ASIC) in *Report 516: Review of mortgage broker remuneration*[2] (ASIC Report) and the third-party recommendations of the *Retail Banking Remuneration Review*[3] (Sedgwick Review) conducted by Stephen Sedgwick AO.

We note that some of the recommendations and findings of the PC in its Draft Report substantially overlap with those in the ASIC Report. Therefore, we believe that the activities of CIF will go some way to addressing the concerns of the PC.

Implementation of these reforms is under way and importantly some of the commitments, such as scrapping volume and campaign-based commissions and making changes to non-monetary benefits, have already been implemented.

The CIF acknowledges that we are at an early stage in this process and we look forward to continuing to work constructively with stakeholders from all corners of the industry, including consumer groups, government and regulators on achieving further positive change.

Consumer engagement

CHOICE, representing multiple consumer groups, has been an active participant in the CIF, as independent consumer advocate. Consumer groups largely welcomed the original reform package proposed by the CIF in December 2017 but advocated for further industry change, notably in areas raised by the PC around trail commissions and best interest duty. The joint press release of the consumer groups in response to the publication of the CIF report is attached at Appendix 3 details some of these concerns.

The CIF has acknowledged that the package of proposed reforms is an important first step. We are committed to implementing them and will monitor their implementation against delivering better customer outcomes. We will continue to work with CHOICE and other consumer groups on advancing consumer outcomes as part of the work being performed by the CIF.

Competition effects of mortgage brokers

Mortgage brokers are actively involved in the Australian lending market. Over 16,000[4] brokers in the market provide their customers with access to lenders via their aggregator's panel, which include most of the 141 Authorised Deposit-taking Institutions (ADIs) as well as many of the other 112 finance companies servicing consumers and small business. The mortgage broking industry is

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[1] *Productivity Commission Draft Report: Competition in the Australian Financial System*, (PC Draft Report) available at: https://www.pc.gov.au/inquiries/current/financial-system/draft/financial-system-draft-overview.pdf

[2] ASIC Report 516 (ASIC Report), *Review of mortgage broker remuneration* (ASIC Report), p9, available at: http://download.asic.gov.au/media/4213629/rep516-published-16-3-2017-1.pdf

[3] Retail Banking Remuneration Review: Report (Sedgwick Review), available at: https://www.betterbanking.net.au/wp-content/uploads/2018/01/FINAL_Rem-Review-Report.pdf

[4] *MFAA Industry Intelligence Service 4th edn*, p8, available at: https://www.mfaa.com.au/sites/default/files/users/user130/IIS.4%20FINAL%201.11.17.pdf

supported by franchise and aggregator businesses that employ thousands more staff and bring scale and efficiency benefits to the industry.

The Draft Report noted the growing proportion of consumers using mortgage brokers. The PC also noted that across the industry over half of mortgages (55.7%) were written through brokers in the July-September 2017 quarter. Consumers continue to search for choice and convenience as well as expertise via brokers when navigating the Australian home lending market. The service and value proposition offered by brokers is different to what is offered through lender channels.

The PC describes how mortgage brokers have assisted smaller lenders to gain access to customers. These lenders may not previously have had geographic reach due to limited physical footprints or operating without a branch network. This in turn has increased competition for consumers.

In March 2017, ASIC performed its largest ever data collection exercise, obtaining data from lenders, aggregators, brokers and others in the market about residential loans written in both mortgage broking and lender channels in 2012 and 2015.

ASIC's report made 13 key findings and six specific recommendations. The findings focused on commission structures; soft-dollar benefits; key characteristics of the broker channel; value chain ownership structures; governance and oversight; and data quality and public reporting.

The ASIC Report outlined the role that brokers play in the home loan market (paragraphs 18 to 22):

- *Brokers play a very important role in the home loan market. They are responsible for arranging around half of all home loans in Australia. Consumers are increasingly turning to brokers to get help in obtaining a home loan—in 2012 brokers arranged 47.7% of home loans for the lenders in our review. In 2015, this increased to 54.3%.*
- *Brokers arranged almost 520,000 new home loans from the lenders in our review in 2015 (compared to 340,000 in 2012).*
- *Brokers can play an important role in promoting good consumer outcomes and strong competition in the home loan market.*
- *From a consumer outcomes perspective, in a well-performing market brokers can help:*
  - *a) match the needs of the consumer with the right home loan product and lender;*
  - *b) navigate the home loan application process, which can be daunting for many consumers; and*
  - *c) improve consumer understanding of home loans and financial literacy.*
- *From a competition perspective, brokers have the potential to:*
  - *a) play a valuable role in providing a distribution channel for lenders-especially smaller lenders-without their own distribution network (e.g. branches); and*
  - *b) exert downward pressure on home loan pricing, by forcing lenders to compete more strongly with each other for business.*[5]

While this data driven review did not present evidence that current remuneration structures are lessening competition or leading to poor consumer outcomes, the ASIC Report did identify conflicts

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[5] ASIC Report, p9.

of interest and the need for change in commission structures. Specifically, ASIC noted that "remuneration and ownership structures can…inhibit the consumer and competition benefits that can be achieved by brokers."[6]

ASIC made the following proposals, that were the basis of the CIF reform package:

1) *Changing the standard commission model to reduce the risk of poor customer outcomes.*
2) *Moving away from bonus commissions & bonus payments which increase the risk of poor customer outcomes.*
3) *Moving away from soft dollar benefits which increase the risk of poor customer outcomes and can undermine competition.*
4) *Clearer disclosure of ownership structures within the home loan market to improve competition.*
5) *Establishing a new public reporting regime of customer outcomes and competition in the home loan market.*
6) *The industry needs to improve the oversight of brokers by lenders and aggregators.*[7]

Interaction with draft productivity review report and ASIC's proposals

As we explain below, we believe there is substantial overlap between ASIC's proposals and the draft findings and recommendations of the PC.

The CIF response to the draft findings and draft recommendations of the ASIC Report in relation to mortgage brokers and their links to the issues identified by the PC are discussed below. In summary, the CIF believes that mortgage brokers have a strong role to play in the mortgage lending market. The CIF will continue to drive change across the industry to improve customer outcomes and reduce and manage conflicts of interest.

About the Combined Industry Forum

The CIF was established in mid-2017 by the mortgage broking industry to drive better customer outcomes in response to the recommendations of the ASIC Report and the Sedgwick Review.

The CIF is made up of representatives from across the mortgage broking industry: including the Australian Banking Association (ABA), Mortgage and & Finance Association of Australia (MFAA), the Finance Brokers Association of Australia Limited (FBAA), and the Customer Owned Banking Association (COBA), and the Australian Finance Industry Association (AFIA), plus bank and non-bank lenders, aggregators, referrer groups, and brokers. As indicated above, consumers have been consulted as part of the CIF governance process and CHOICE is part of the CIF governance committee. A full list of CIF participants is set out in Appendix 1.

To drive better customer outcomes and manage conflicts of interests raised in the ASIC Report, the CIF submitted a package of reforms to the Australian Government in December 2017.

Implementation began immediately, with all proposals to be implemented by 2020. See the full list of proposals in Appendix 2.

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[6] Ibid.
[7] ASIC Report, p23.

Response to Productivity Commission Draft Report – Draft Findings, Draft Recommendations and Information Requests pertaining to mortgage brokers

Draft Finding 8.1 – Interest Rates from Brokers vs. Other Channels

The introduction of mortgage brokers into the market in the late 1980s has served to increase competition, provide customers with convenient access to a wider range of lenders, and pressure lenders to compete and win customers through both broking and proprietary channels.

The PC noted that home loans originated via mortgage brokers have only slightly lower interest rates than those originated through direct channels. This aligns with the findings of the ASIC Report, which did not identify or show consistently cheaper or more expensive loans written through mortgage brokers.[8]

Rates between channels are generally aligned because lenders are channel agnostic and focussed on providing the most competitive price for the individual customer. Rates are generally aligned between channels because lenders have responded to the competitive pressures put by mortgage brokers.

A current role of the broker is to find a competitive rate given the customer's individual characteristics. There are instances where a client will have potentially been able to negotiate a rate of for example, 4.4% directly with their lender, but after seeking a broker, they were able to obtain 4% with the recommended lender. This is positive for the consumer and a much more common outcome than that customer being able to negotiate a better rate with their lender.

Importantly, interest rate is just one component of the overall broker proposition with choice and desired product and service features aligned with the customer's objectives.

As part of ASIC's Proposal 5, in establishing a new public reporting regime of customer outcomes and competition in the home loan market, it proposed that there be public reporting on the average pricing of home loans provided by lenders according to each distribution channel.[9]

Consistent with this proposal, the CIF has committed to providing additional reporting to ASIC, including the weighted average pricing of home loans in the previous financial year across their different distribution channels using standard scenarios (to be defined) in order to improve transparency around the rates between channels.

Draft Finding 8.2 – Cost of Home Loans through Branches vs. Brokers

Comparing proprietary and broker channels is not comparing apples with apples. Brokers are generally more experienced, offer different services and alternate modes of delivery of those services (e.g. at home) as well as offering a different service proposition to that provided by lenders.

Lenders will incur a distribution cost regardless of whether a loan is sold through a broker or a branch. There are complexities in ascertaining the cost of origination in either the branch or broker network and therefore comparison is difficult. Each lender will define and attribute the cost of origination in the relevant channel differently and it depends in large part on the way lenders

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[8] ASIC Report, p15.
[9] ASIC Report, pp25-26.

allocate costs for branches, online and phone support, technology, finance, overheads and other costs between different activities.

Given these different approaches, the industry has not adopted a consistent methodology for determining the cost of distribution between channels and it is unclear that changes to remuneration structures would result in net savings for consumers.

Lenders believe that it is more useful to focus on the value delivered by each channel, rather than between channels. Regardless of the economics of each channel, consumers are choosing in increasing numbers to use mortgage brokers and for lenders to be competitive they will choose to distribute loans through mortgage brokers.

Brokers are an important variable cost channel and allow all lenders to scale up and down distribution through broker networks, as well as being an essential channel for lenders that do not have any branches or extensive branch networks. Mortgage brokers enable smaller lenders to gain wider reach and increase product variety in the home loan market. This is particularly important given originating mortgages digitally is in its infancy.

Draft Recommendation 8.1 – Duty of Care Obligations for Lender-Owned Aggregators

'Good Customer Outcome'

The industry is already taking steps to improve the standards that mortgage brokers are held to and has committed, through the CIF, to apply a new definition of 'good customer outcome' as follows:

"The customer has obtained a loan which is appropriate (in terms of size and structure), is affordable, applied for in a compliant manner and meets the customer's set of objectives at the time of seeking the loan."

A 'Good Customer Outcome' is at the centre of what we are striving to achieve, whether it be lender, aggregator, mortgage broker or other industry participant. The above definition sets out four key measures that need to be satisfied to determine a 'Good Customer Outcome':

- Appropriate size and structure of the loan;
- Meeting the customer's stated requirements and objectives;
- Affordability for the customer; and
- Applied for in a compliant manner (meeting all responsible lending requirements).

The definition incorporates the existing law, and holds the industry to a new standard, above compliance with responsible lending, to consider whether the loan is appropriate and whether the loan meets the customer's requirements and objectives. Changes to reporting and governance proposed by the CIF will help ensure this standard is upheld throughout the mortgage broking industry.

Perceived ownership conflicts

In its Proposal 4, ASIC noted the potential impact of ownership structures on competition in the home loan market. It has therefore proposed that industry participants be required to more clearly disclose their ownership structures.[10] To respond to ASIC's proposal and assist in managing

[10] ASIC Report, p25.

perceived conflicts of interest in some aggregator ownership structures, the industry has committed to prominently disclosing these ownership structures where 'significant influence' is exerted (e.g., where a board seat is held, or ownership is greater than 20% or a white label product is offered by a substantial shareholder).

Professional standards

The mortgage broking industry has an established structure of conduct and competency standards and obligations through industry led self-regulatory initiatives, including:

- the Finance Brokers Association of Australia's (FBAA) Code of Conduct, and
- the Mortgage & Finance Association of Australia's (MFAA) Code of Practice.

For example, the MFAA's Code of Practice[11] has been in place since 2000 and establishes the professional standards that apply to members. The accompanying MFAA Disciplinary Rules[12] establish an enforcement process and give the MFAA Tribunal the power to expel, suspend or sanction members found to have breached the Code. The Tribunal is externally appointed to minimise the potential for bias or conflict of interest.

Under this regime, complaints about MFAA Members that are supported by satisfactory evidence are fully investigated and determined by the Tribunal. More than 450 matters have been referred to the Tribunal since late 2003, resulting in 94 serious sanctions being imposed on members (expulsion (47), or suspension (37) or cancellation (10) of membership). The names of members subject to serious sanctions have been published on the MFAA website since 2004 to inform consumers and the industry. Since 2007, additional information about the reason for the particular sanction has also been included.

Information Request 8.1 – How should new Duty of Care obligations for Lender-Owned Aggregators be implemented?

The industry is choosing to implement the new definition of 'good customer outcomes' through an industry code. The code, to be developed through the CIF, would apply to mortgage brokers, lenders, aggregators and, where appropriate, introducer / referral businesses and would be subject to all applicable regulatory and competition law approvals.

We believe introducing the new obligations through an industry code provides a meaningful path for industry and consumers to develop a standard that is fit for purpose.

Information Request 8.2 – Should consumers pay brokers fee for services?

Consumer paid fee for service charges may reduce lender choice and product strategy conflicts, and therefore the CIF has not proposed to introduce such a service model. Instead we have focused on changing the standard commission model to reduce specific conflicts of interest. We are concerned that such a model may:

- result in additional direct costs to consumers to access the broker channel;
- put brokers at a significant disadvantage to the lender branch channel (who do not charge direct fees);

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[11] Mortgage & Finance Association of Australia, *Code of Practice*, https://www.mfaa.com.au/about-us/governance/code-of-practice.
[12] Mortgage & Finance Association of Australia, *Disciplinary Rules*, https://www.mfaa.com.au/about-us/governance/disciplinary-rules.

- result in rationalisation of broker numbers, increasing barriers to entry for new lenders, whilst disadvantaging smaller lenders and those without a branch footprint
- not correlate to economic value produced by the broker; and
- result in brokers servicing a much narrower band of customers.

Importantly, there is little evidence that there would be any net saving to customers if a consumer fee for service model is introduced.

There may also be unintended consequences, that would limit customer access to mortgage broking and affect competition. The current model spreads the costs in line with loan size and value. It is possible that if consumers pay directly, those with low loan sizes may face higher fees and therefore will no longer find the broker's services affordable, pricing them out of the market. This could have the perverse impact of reducing access to competition for consumers with complex needs.

Neither the Sedgwick Review nor the ASIC Report recommended the adoption of a consumer pays model. Recommendation 6.1.2 of the Sedgwick Review noted "it is a fundamental principle of this Recommendation that, in any new arrangements, competition should be preserved, and the viability of the mortgage broking industry maintained…It is for this reason that client funded fee arrangements are not supported by the Review".[13]

Draft Recommendation 8.2 – Mortgage Broker Disclosure Requirements

The Productivity Commission touches on clearer reporting to customers in two areas: lending information (including the number of lenders available to the broker, commissions received, etc.) and ownership structures. Both aspects were addressed by ASIC through its Proposal 5 and will be materially addressed by the proposed CIF reforms. We believe that any final position of the PC on consumer disclosure should align with ASIC's proposals.

Public Reporting Regime

ASIC proposed that a new public reporting regime be established, detailing customer outcomes and competition in the home loan market. The CIF committed to implement this proposal by the end of 2018 via reporting to ASIC and customers information that more clearly outlines the choice provided to customers. Specifically, the CIF has proposed that the following disclosures are made:

Brokers disclose to customers:

1) The list of lenders available to the customer via the broker's aggregator;
2) The number of lenders that a broker has used in the past year; and
3) The top 6 lenders and % of business written in the past year.

Aggregators will disclose:

1) All lenders available on their panels and percentage written with each over the past year;
2) The spread of lenders being used by brokers; and

[13] Sedgwick Review, p23.

3) Weighted average commission rate percentage earned in the past year.

Lenders will disclose to ASIC:

1) The weighted average pricing of home loans in the previous financial year across their different distribution channels using various standard scenarios (to be defined).

The CIF believes the above disclosures will address the concern raised by the PC around "overstat[ing] the level of choice available to customers as individual brokers are not necessarily accredited by all lenders on an aggregator's panel"[14].

Under NCCP, there are already material disclosures required to customers on mortgage broker commissions. The additional disclosures proposed by the CIF will provide greater transparency to customers around prices in various channels and how mortgage brokers are paid.

We note that ASIC commended the role that mortgage brokers play in financial education for consumers, through "improv[ing] consumer understanding of home loans and financial literacy" [15].

Impact of Ownership Structures

ASIC noted the potential impact ownership structures could have on competition as part of the ASIC Report and proposed clearer disclosure of ownership structures[16].

In response, the CIF proposed implementation of clearer disclosure practices by all participants in the industry by end 2018 (Reform #4). These changes include clearer disclosure of ownership structures and other circumstances in which participants in the industry may have the ability to exert influence:

- Disclosure of ownership structures will be required if 'Significant Influence', as guided by the definition in Australian Accounting Standard 128 (AASB 128), is deemed to be exerted over a participant in the industry. Disclosure of ownerships structures would be required where, for example:
  - Ownership is 20% or greater; or,
  - Where ownership is less than 20%, a board seat is held or a white label product is offered by a substantial shareholder (as defined);
- Disclosure of ownership structures should extend beyond mortgage brokers and apply to all players in the home loan distribution chain, including lenders and aggregators; and
- Disclosure of ownership structures should be included in marketing material, digital formats and at all distribution points (e.g. websites and at physical premises).

The CIF believe this will address the PC's recommendations around disclosures on ownership relationships between lenders and aggregators, when that ownership is greater than 20%.

Similar to the Productivity Commission's recommendation, the CIF intends to test disclosures with customers.

[14] PC Draft Report, p.217.
[15] ASIC Report, p9.
[16] ASIC Report p25.

Draft Finding 13.1 – Mortgage Broker Commission Structures Weaken Consumer Switching

The CIF has agreed to change the way that commissions are calculated and to consider further changes where remuneration structures have been found to be driving poor behaviour by brokers. We have also made other substantial changes in terms of scrapping volume-based bonus commissions and campaign-based commissions in alignment with ASIC's Proposal 2 and Recommendation 16 of the Sedgwick Review. These are specifically intended to address the competition issues identified by ASIC relating to these types of payments.[17]

The CIF believes that 'clawback' is an effective lever for ensuring that the loan will perform and drive the right behaviours among brokers. Therefore, we have committed to retaining clawbacks as part of the standard commission model.

Trail provides an ongoing income stream so that the broker can appropriately service the customer over the life of the loan. Trail is also used as a lever to promote good customer outcomes, as it is standard industry practice to 'switch off' if the loan goes into arrears or enforcement action is taken. It is the CIF's firm view that trail is not a barrier to switching or a disincentive for brokers to service clients.

Effect of regular switching and mortgage churn

The CIF believes that consumers should switch loans, when they can get a substantially better deal. However, mortgages are products that are designed to operate for 5 – 30 years and data from one aggregator in their portfolio show that loans are refinanced every 3.8 – 4 years. They form the cornerstone of the financial affairs of many families, and many families transact through their mortgage accounts and arrange their affairs (credit cards, other savings) with one financial institution.

If the loan is established in line with the customer's requirements and objectives, there are very few reasons in the customers interests to switch the loan regularly and frequently. Regular and frequent switching increases administrative costs, which may be passed on to the consumer, without corresponding savings in fees or interest rates. It is also industry practice for a broker to negotiate a better deal with the client's existing lender, rather than refinance or refinance with a new lender.

Information Request 13.2 – Is there a rationale for the structure of mortgage broker commissions?

The current standard commission model includes upfront commission paid on settlement of the loan, as recognition of economic value created by the broker for the lender, and trail commission paid over the life of the loan, which supports the broker to provide ongoing service to their customer base over time.

ASIC "found it common for remuneration structures to pay commissions on the total amount of borrowing approved, rather than the amount of funds drawn down"[6]. We believe the principle adopted by CIF members, to pay commissions based on the funds being utilised by the customer directly addresses the biggest risk to consumers arising from product strategy conflict. Mortgage

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[17] ASIC report, p145.

brokers will no longer be paid on facility limits or have a financial incentive to recommend larger loans that initially have large offset balances.

The CIF have proposed this principle to promote good customer outcomes, specifically to ensure the appropriate size of the loan for customers and to discourage large initial offset balances. When coupled with the governance framework proposed by the CIF, to be developed through 2018, this is a significant step forward.

Commitment to change

However, the CIF has recognised the potential conflicts of interest related to the current commission model and has committed to adopting a principle that: "To the extent that remuneration relates to loan size, remuneration should relate to the funds drawn down and utilised by a customer".

The industry considers that this principle would be satisfied where, for example:

- Upfront commission is paid on a utilisation basis, that is:
  - based on facility limit drawn down by the customer; and
  - in cases where the loan has an offset account, on the amount drawn down net of offset account balances,
- Trail commission is paid on the amortised drawn down amount net of offset account balances or based on facility utilised, and
- Clawbacks remain part of the standard commission structure.

Generally, funds drawn down would be measured and commission paid on initial settlement and at a later point in time for subsequent drawn down amounts, up to the maximum facility limit.

The CIF recognises that this approach to funds drawn down and utilised may require further consideration in certain limited circumstances, such as residential construction lending.

As long as this principle is satisfied, there should be no restrictions placed on lenders adopting additional methodologies of calculating commission payments. Arrangements that meet this principle will be in place by end of 2018.

The CIF has proposed this principle to promote good customer outcomes, specifically to ensure the appropriate size of the loan for customers and to discourage large initial offset balances. Adopting this principle is a first step for the industry. The industry intends to use the improved governance framework to closely monitor customer outcomes and the impact of the reforms. Where remuneration structures are found to be driving poor behaviours and customer outcomes, the industry will consider further changes to remuneration structures.

Concluding comments and path forward

The CIF believes that mortgage brokers contribute positively to competition in the mortgage lending market. Consumers are voting with their feet and continuing to choose to get their loans through brokers in ever increasing numbers. The CIF will continue look to drive change that improves customer outcomes and promote a competitive and vibrant mortgage broking industry.

Appendix 1 – CIF members

Industry stakeholders who participated in the Combined Industry Forum:

Company Name	Group
ABA	Industry Association
AFIA	Industry Association
Australian Finance Group (**AFG**)	Aggregator
AMP Bank	Lender
Australia and New Zealand Bank (**ANZ**)	Lender
Astute	Aggregator
Bendigo and Adelaide Bank	Lender
BeckMitch Consulting	Broker
Bank Of Queensland	Lender
Commonwealth Bank of Australia	Lender
CHOICE	Consumer Advocacy Group
Choice Aggregation Services	Aggregator
COBA	Industry Association
Credit Union Australia (**CUA**)	Lender
Connective	Aggregator
Divitis Finance	Broker
FAST Group	Aggregator
FBAA	Industry Association
Foster Finance	Broker
GRACosway	Consultants
Gilbert + Tobin Lawyers	Independent Legal Advisors
Heritage Bank	Lender
ING	Lender
Lendi	Broker
Liberty Financial	Lender
Loan Market	Aggregator
ME Bank	Lender
MFAA	Industry Association
Mortgage Choice	Aggregator
National Australia Bank	Lender

Nexus Partners	Referral Aggregator
National Mortgage Brokers	Aggregator
PLAN Australia	Aggregator
SmartMove	Broker
Suncorp	Lender
Tailored Lending	Broker
Westpac	Lender

Appendix 2 – Proposals

<table>
<tr><th>ASIC's Proposals</th><th>CIF Reforms</th></tr>
<tr><td>1. Changing the standard commission model to reduce the risk of poor customer outcomes

[Sedgwick recommendation 18]</td><td>The industry recognises the potential for financial incentives to put good customer outcomes at risk where they encourage customers to borrow more than they need.

The CIF considers that industry participants may address this risk by adopting the following remuneration principle:

"To the extent that remuneration relates to loan size, remuneration should relate to the funds drawn down and utilised by a customer".

The industry considers that this principle would be satisfied where, for example:

• Upfront commission is paid on a utilisation basis, that is:
- based on facility limit drawn down by the customer; and
- in cases where the loan has an offset account, on the amount drawn down net of offset account balances,
• Trail commission is paid on the amortised drawn down amount net of offset account balances or based on facility utilised, and
• Clawbacks remain part of the standard commission structure.

Generally, funds drawn down would be measured and commission paid on initial settlement and at a later point in time for subsequent drawn down amounts, up to the maximum facility limit.

The CIF recognises that this approach to funds drawn down and utilised may require further consideration in certain limited circumstances, such as residential construction lending.

As long as this principle is satisfied, there should be no restrictions placed on lenders adopting additional methodologies of calculating commission payments.

Additional arrangements for the eligibility of trail commission based on customer outcomes are set out in proposal six.

Implementation by end 2018</td></tr>
<tr><td>2. Moving away from bonus commissions and bonus</td><td>The industry recognises the potential for volume-based bonus commissions, campaign-based commissions and volume-</td></tr>
</table>

payments which increase the risk of poor customer outcomes [Sedgwick recommendations 16. a) and 16. c)]	based bonus payments paid by lenders and aggregators to brokers or by lenders to aggregators to put good customer outcomes at risk. The industry also recognises ASIC's expectation that the industry moves away from these commission and payment structures. All industry participants should respond to ASIC's recommendation by 31 December 2017. In practice, many industry participants have already taken individual decisions to cease these payments. The industry recognises that volume-based payments from lenders to aggregators can also raise conflicts. Financial support, provided by lenders to aggregators, for compliance education and training that lead to better customer outcomes is not likely to raise conflicts as long as such support is not based on volume of loans written with any particular lender and do not form a condition of being on the aggregator's panel of lenders. Discounted or free aggregation as a result of writing aggregator white label loans, or any specific lender's loans, has been removed from the industry, and the industry does not support the return of this practice. While not a change specifically proposed by the ASIC Report or the Sedgwick Review, this move demonstrates the intent of the industry to address areas of potential conflict that may not result in good customer outcomes. **Implementation by end 2017**
3. Moving away from soft dollar benefits which increase the risk of poor customer outcomes and can undermine competition Specific areas considered: Tiered servicing (Broker Clubs) Conferences/Professional development events Entertainment and Hospitality	<u>Tiered servicing</u> Access to a Lender or Aggregator's tiered service model should be determined using a balanced scorecard, with a maximum 30% volume component, as a proxy for productivity, as well as other criteria aligned to 'Good Customer Outcomes'. Access to a tiered service model will be disclosed by the broker where they are recommending a product from that particular lender. Such programs should not entitle brokers to preferential customer discounts or to additional payments or commissions. Instead, these programs should provide preferential service which can assist customers in achieving better outcomes.

[Sedgwick recommendation 16. b)]	Conferences and Professional Development Professional development and most education is available to all brokers to ensure ongoing competency and professional development. All conferences and professional development events must be educationally focussed (with a minimum of 80% identified education content) and aimed at continually improving customer outcomes. Minimum education and professional development for brokers is not considered a reward but as driving a level of competency to improve customer outcomes. Locations for conferences and professional development must be business appropriate and not likely to cause reputational harm to the industry. In some circumstances, additional education opportunities are offered. Broker access to these additional opportunities should be based on a balanced scorecard, which does not include volume. Entertainment and hospitality The industry recognises that the provision of high-value entertainment and hospitality may raise the risk of lender choice conflicts. The industry considers that this risk may be addressed by ensuring that lenders do not provide entertainment or hospitality to mortgage brokers that has a value of more than $350 per person, per event and is not based on the volume of loans written by the broker. This value was chosen to align with Fringe Benefit Tax (FBT) reporting, which enables lenders and aggregators to use existing reporting for better monitoring and supervision. Aggregators will not determine eligibility for entertainment or hospitality, wholly or partly, on the volume of loans written with any one lender or white label loan product. For entertainment or hospitality above $100, lenders, aggregators and brokers will be required to maintain their own register of entertainment and hospitality benefits (given or received) on a rolling 12 month basis, with records kept for three years. ‘Entertainment and hospitality’ does not include professional development and education events, that have more than 80% identified education content and are offered in a business appropriate location.

<table>
<tr><td></td><td>This register should be kept current, advertised in the Credit Guide provided to customers and monitored by aggregators and details provided on request.

<u>Lender Sponsorship of Aggregators and Events</u>

Sponsorship opportunities to an aggregator event should be made available to the aggregator’s entire lender panel. As above, the aim of any event is to increase education. Further, the ability to join an aggregator’s panel should not be contingent on the level of sponsorship provided.

Implementation by end 2018</td></tr>
<tr><td>4. Clearer disclosure of ownership structures within the home loan market to improve competition</td><td>To reduce the potential impact of ownership structures on competition in the home loan market, we propose that participants in the industry more clearly disclose their ownership structures and other circumstances in which they may have the ability to exert influence.
Disclosure of ownership structures will be required if ‘Significant Influence’, as guided by the definition in Australian Accounting Standard 128 (AASB 128), is deemed to be exerted over a participant in the industry. Disclosure of ownerships structures would be required where, for example:
Ownership is 20% or greater; or,
Where ownership is less than 20%, a board seat is held or a white label product is offered by a substantial shareholder (as defined);
Disclosure of ownership structures should extend beyond mortgage brokers and apply to all players in the home loan distribution chain, including lenders and aggregators; and
Disclosure of ownership structures should be included in marketing material, digital formats and at all distribution points (e.g. websites and at physical premises).
The CIF suggests carrying out customer testing of disclosure formats and standards (once designed) to ensure clarity and maximum benefit.

Implementation by end 2018</td></tr>
</table>

5. Establishing a new public reporting regime of customer outcomes and competition in the home loan market [Sedgwick recommendation 19]	Below, the CIF proposes providing particular information to ASIC and would like to work with ASIC on approaches to de - identify and aggregate the information, for publication. Aggregators to publish and provide to ASIC: • List of all lenders available on panel and percentage share of business written with each over the previous financial year, • Spread of number of lenders being used by brokers in the group/aggregator (in the last 12 months): - % brokers using < 3 lenders; - % brokers using 4 – 7 lenders; - % brokers using 8+ lenders; and • Weighted average commission rate percentage earned in the previous financial year for mortgages. Lenders to provide to ASIC: • Weighted average pricing of home loans in the previous financial year across their different distribution channels using various standard scenarios (to be defined). Further work is required with ASIC and the industry to agree a standard model to analyse and present the pricing information, particularly taking into account variables such as the effect of interest rate movements. Brokers to publish to customers: • List of lenders available to the customer via the broker's aggregator; • Number of lenders used in the previous financial year; and • Top six lenders and % of business written in the previous financial year (Note: if the individual broker has not been in business for 12 months then this would be N/A). **Implementation by end 2018**
6. The industry needs to improve the governance and oversight of brokers by lenders and aggregators	The industry proposes introducing an improved Governance Framework under which the industry would self-assess, self-correct and continuously improve.

[Sedgwick recommendation 17]	This framework would comprise: • Key Risk Indicators, which would act as triggers/flags for potential poor customer outcomes; • Unique identifiers, to allow for more complete reference checking and identification of poor performers; • Annual reviews of individual aggregator and broker governance frameworks; • Data based broker monitoring; • Customer feedback and shadow shopping to ensure reforms are ensuring good customer outcomes; • Reporting and ongoing review of remuneration structures, including upfront, trail and clawbacks, to the extent they negatively impact customer outcomes; and • Remediation, such as training, education, and recognition. This work is already underway and will be ongoing. *Key Risk Indicators* Key Risk Indicators would need to be reported from Lender to Aggregator/Broker around the potential for a poor customer outcome. These indicators provide data based direction to the allocation of oversight effort and resources and could/would include the following relative to the industry average: • % of portfolio in Interest Only, as an example of a product and whether for investment or owner occupier purposes; • Arrears (60+ days or average weighted arrears in the first 12 months); • “Switching” in the first 12 months of settlement; • Elevated level of customer complaints; • Poor post settlement customer survey results of the broker experience; and • The quality of the loan, identified through any deficiencies found in Requirements and Objectives (R&O) documentation which would include moving to a more robust capture of the

	R&O by the lender as a separate initiative (potentially through establishment of an Industry Guide for capturing such information). *Unique Identifiers* The industry intends to work with Government to implement a unique identifier for each broker and introducer/referrer to lender, noting there is investigation required around how this can be implemented. The unique identifier should be held on a 'register' of brokers maintained as a reference checking protocol for credit professionals moving between aggregators or moving from working with a lender to an aggregator. Ideally this identifier would be maintained throughout a person's career across financial services industries, such as financial planning, mortgage broking, referring / introducing and as a lender employed banker, and be managed centrally by ASIC. Once fully implemented this identifier would be used by aggregators, lenders, associations and ASIC, and be held against all loans lodged at the lender level to assist with data analytics. *Customer Feedback* There should be ongoing customer feedback gathered to review whether a 'Good Customer Outcome' has been achieved. An industry standard to obtain this feedback needs to be designed but would become integral to the aggregators' monitoring of brokers, creating a 'test and learn' environment. *Remediation* In conjunction with proposal one, and along with training, education and recognition, the industry considers that good customer outcomes are promoted by withholding the trail commission if: • A loan is 60+ days in arrears; and/or • A loan is found to have been calculated using inaccurate information allowing a customer to receive a larger loan (trail not paid if any fraud found in the application); and/or • A loan is refinanced or restructured, which may be potential evidence of not being fit for purpose. **Implementation end 2020**

APPENDIX 3 – Consumer Groups Media Release

Choice Consumer Group, Consumer Action Law Centre, Financial Rights Legal Centre, Financial Counselling Australia

BROKER CHANGES WELCOMED BY CONSUMER GROUPS

Consumer groups welcome industry first steps to reform mortgage broker remuneration and governance

Consumer groups CHOICE, Consumer Action, Financial Rights Legal Centre an Financial Counselling Australia are welcoming the announcement today from mortgage broker, aggregator and lender groups about reforms to how brokers are paid and held accountable for consumer outcomes.

The announcement from industry is in-part a response to an ASIC report into mortgage broker remuneration, released in March this year.

Quotes attributable to Erin Turner, Director – Campaigns & Communications, CHOICE:

"This announcement from the mortgage brokers, aggregators and lenders is a positive first step towards ensuring that mortgage brokers act in customer interests."

"We are pleased that that industry will continue to develop and implement reforms over 2018 and work towards an enforceable ASIC-registered code. This is a meaningful commitment that, when achieved, will set the mortgage broking sector apart from other segments of the financial services industry."

"Today's announcement shows that all parties in the home lending industry have taken ASIC's report into mortgage broker remuneration seriously. For example, the industry will be removing bonuses and other payments for brokers that write a certain volume of loans."

"The changes should lead to a greater degree of transparency. Consumers will have access to new information from brokers including the number of lenders the broker has used in the previous year and the percentage of business that the broker wrote to the top six lenders they use."

"However, the mortgage broking and home lending industries will need to continue to evolve if they are going to genuinely put customer interests first."

"We are disappointed that brokers aren't required to act in the best interests of consumers and that there are few changes to overall commission structures. In particular, there is little clarity about the consumer benefit of trail commissions. While the mortgage broking industry and lenders state that trail commissions are necessary to support customers over the life of a loan they have not specified what service a customer can be guaranteed to receive."

"Consumer groups will continue to discuss these reforms with industry and look forward to their implementation."