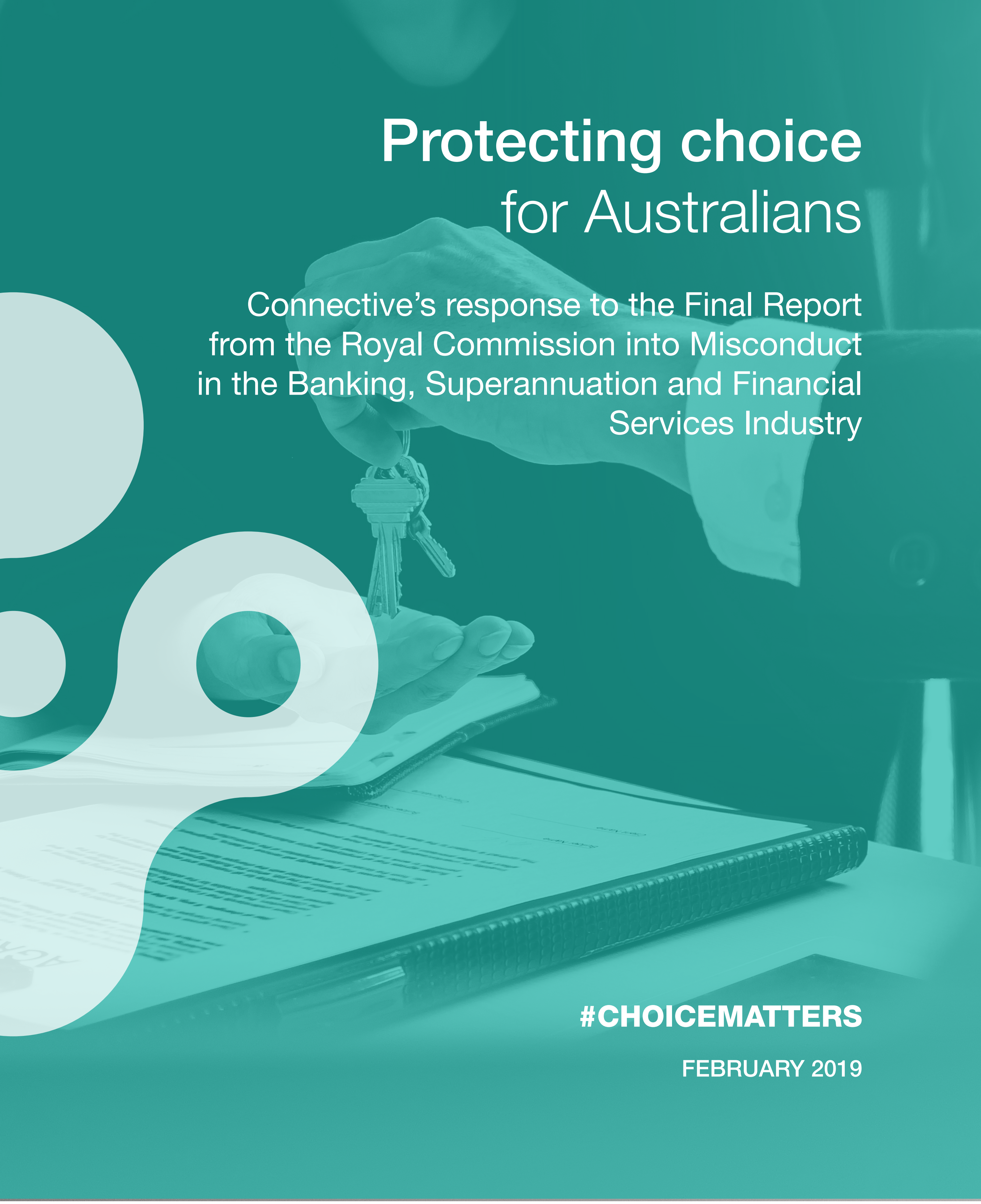

Protecting choice for Australians

Connective's response to the Final Report from the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry

#CHOICEMATTERS

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Executive Summary


Left to right: Glenn Lees, Mark Haron

The Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry has put Australia's financial services sector under the microscope. There were 76 recommendations included in the Final Report, 10 of which directly impact the mortgage broking industry.

Whilst we are supportive of the Royal Commission in principle, we believe many of the recommendations made in the Final Report in relation to the mortgage broking industry are fundamentally flawed. They will do more harm to borrowers and competition than they will to address any perceived issues within the mortgage broking industry.

Connective has always been an advocate for mortgage brokers and we will continue to work with our brokers to put their customer's needs first. Throughout the Royal Commission we have taken a leadership position within the industry and continue to stand side by side with our brokers. We have spoken out against change that will adversely affect everyday Australians, impact choice and competition, and drastically affect the livelihood of the 27,000 full time jobs in the mortgage broking industry.

We've outlined our response to the key recommendations relating to our industry in this document, in summary:

Mortgage Broker Remuneration

- We unequivocally reject the recommendations to change the mortgage broker remuneration model in relation to both a borrower-pays model and the removal of trail commissions.

- There have been a number of changes introduced to how brokers operate and the broker remuneration model, most recently around upfront commissions being calculated on the net drawn amount net of any amounts in an offset account and the introduction of improved disclosure requirements. These changes have been adopted by Connective and more broadly, the industry.

- Mortgage brokers provide consumers with greater access to lenders beyond the big banks, including small and regional lenders without retail outlets. Further changes to the remuneration structure as per the recommendations will ultimately remove access to choice and competition in the home lending sector and this will simply hand more power and profits back to the major banks.

Best Interests Duty

- We've always supported putting customers' interests first and therefore in principle support Hayne's recommendations for a 'Best Interests Duty' to apply to mortgage brokers. However, questions remain in relation to how a 'Best Interests Duty' should be defined and how it will extend to all participants in the home lending industry, including the banks.

- Improving customer outcomes requires a level playing field for all parties in the sector. The current recommendation only applies to brokers but not lenders. This is inconsistent, will be ineffective, and quite frankly, creates double standards.

- Our message remains steadfast: mortgage brokers are integral to giving Australian borrowers choice and maintaining healthy competition in our home lending market. Limiting choice and forcing Australians to pay an upfront fee to access a mortgage broker will only exacerbate the issue of housing affordability in our country.

- There is still a long way to go before any of the final recommendations from the Royal Commission, or iterations of them, are implemented. And the devil, will be in the detail.

- We will continue to campaign on behalf of our brokers and the mortgage broking industry, work with industry groups and our fellow aggregators, and amplify our #CHOICEMATTERS campaign to ensure the best policy outcomes for our customers and Australian home buyers.

Glenn Lees, CEO

Mark Haron, Executive Director

Myth Busting:
Let's get the facts on the value of mortgage brokers

Myth	Reality
1. Trail commissions are a fee for no service	Trail commission represents a deferment of the fee payable to the broker and a sharing of the risk (and revenue) of the loan. Historically, upfront commissions paid by lenders to mortgage brokers were much higher than they are now, with no trail subsequently payable. In order to reduce their upfront costs (especially if a loan was prepaid early), lenders moved towards the current model of a lower upfront commission plus ongoing trail commission whilst the loan remained outstanding and performing. Trail commissions provide recognition and incentive for brokers to provide additional support and services to the customer. Over time, having access to a mortgage broker who provides the support to ensure customers remain with the most appropriate product for them, is valuable. There is also a belief that the payment of trail commissions create a disincentive for a broker to churn (frequently refinance the loan for the primary purpose of generating further commission without a tangible benefit to the customer). Removing trail commissions, as recommended by Hayne in the Final Report, will only add to diminishing competition in the home-lending industry whilst further profiting the banks. Furthermore, Peter Switzer articulated, in the Switzer Report on February 5, 2019: ***"As for trailing commissions, while intermediaries will be prohibited from receiving them, it is obvious that banks effectively pay those commissions to themselves, and will continue to do so."*** He continues by stating a view held by millions of Australians: ***"…. if I have a million dollar loan and a broker takes my interest rate down from 5% to 4%, he or she saves me $10,000 a year on an interest only loan, and if the broker gets $1,500 or 0.15% trail, I don't care."*** **Peter Switzer,** Australian business and financial commentator

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Myth	Reality
2. Mortgage brokers act on behalf of lenders, not borrowers	If a mortgage broker failed to look after their customers' best interests, they would not have a sustainable business. The majority of mortgage brokers are small businesses and generally, they rely on personal references and word of mouth for business; their quality of service and integrity are critical to their survival. Today, the upfront and trail commission rates lenders pay mortgage brokers are largely uniform across the home loan industry. There is no benefit for mortgage brokers to act on behalf of a lender opposed to their customer; in fact there is only potential down-side in not putting the customer first. The mortgage broking industry has already acted to remove any perceived incentives from lenders and correct any misconception that they are not acting on behalf of borrowers first and foremost. Incentives from lenders such as volume-based payments and soft dollar benefits, which are potential avenues for a lender to influence a broker, were prohibited from 31 December 2017[1]. More choice for consumers results in greater pressure on interest rates and this is a positive outcome for all consumers, regardless of whether they use a broker or go direct to their lender of choice. Broker-driven competition has contributed to a fall in net interest margins of more than three percentage points over the last 30 years. This is equivalent to savings of more than $300,000 on a $500,000 thirty-year loan[2]. Removing choice will only put more power in the hands of major financial lenders and reduce access to smaller lenders. Without choice, only the big lenders stand to win. Ultimately, all Australian property buyers stand to lose, not just those who use the services of a mortgage broker. What's more, 96 per cent of Australians who use brokers said they were satisfied with them compared to just 67 per cent who deal directly with lenders[3].

1. Deloitte Access Economics, The Value of Mortgage Broking, July 2018
2. Based on an interest rate fall from 7% to 4% per annum
3. Momentum Intelligence, Consumer Access to Mortgage Report

Myth	Reality
3. Mortgage brokers are excessively remunerated for relatively simple work	Most people don't see the time a broker dedicates to each customer file to ensure the application is successful the first time, or the time they spend answering questions, educating and supporting their customers to make good decisions, or helping to resolve their individual credit issues. Whilst brokers deal in rate, flexibility and convenience, one of the most valuable aspects of a broker's role is in solving and managing the ever-increasing complexity in Australia's home lending market. As most brokers know, credit policy, documentation requirements and credit appetite of lenders is varying with increasing frequency and amplitude. Helping customers navigate increasing complexity is an ongoing service that brokers provide. In addition, a broker assists their customers with post-settlement matters, much of which derives no additional revenue for the broker and, in some circumstances, may result in a reduction of that broker's revenue (through a repayment of loan).

Myth	Reality
4. Shrinking – or killing – the mortgage broking industry won't kill competition in the home lending market	Since the release of the Final Report recommendations there has been much commentary about the many benefits mortgage brokers provide to Australian borrowers, most obviously choice, convenience and healthy competition. There have also been predictions that the implementation of the recommendations from Hayne could significantly shrink, or indeed diminish, the mortgage broking industry, which would detrimentally impact competition. We believe it is best articulated by the following comments: As stated by Henry Ergos AO, Economist and columnist, in The Australian on February 8, 2019: ***"But if there is such a thing as an undeniable fact, it is that the rise of mortgage brokers and financial advisers did more to inject competition into the financial services industry than decades of efforts by governments and regulators combined.*** ***They introduced comparison shopping into an area where consumers find comparisons notoriously hard to make. And every bit as importantly, they acted as distribution outlets for smaller providers — such as credit unions — that lacked (and lack) a national retail presence."*** **Henry Ergos AO** Economist and columnist

Connective's Response

Hayne Recommendations

Recommendation 1.2 - Best Interests Duty

The law should be amended to provide that, when acting in connection with home lending, mortgage brokers must act in the best interests of the intending borrower. The obligation should be a civil penalty provision.

Connective Position

We absolutely agree that mortgage brokers should act in the best interests of their customer. Although not formally legislated, a mortgage broker would not have a successful business if they did not act in the best interests of their customers.

Questions remain however, in relation to how the 'Best Interests Duty' will be defined and whether it will extend to all lenders, including the banks.

Achieving good customer outcomes requires a level playing field for all parties in the home lending sector. Applying a 'Best Interests Duty' to brokers but not lenders is inconsistent and ineffective.

Hayne recommends the 'Best Interests Duty' must be enforceable by civil penalty. We support this recommendation provided the duty is appropriately defined for the purposes of the home lending sector.

Let's remember, on the whole, mortgage brokers are getting it right. More than 90% of mortgage broker customers are happy with their broker's performance and close to 60% of all new residential home loans during the September 2018 quarter were settled by a mortgage broker.

What we're doing

Connective has been working with the CIF, which was established in response to the Asic Review, to develop and implement meaningful reform that will improve standards in the industry.

The industry has developed a definition of 'Good Consumer Outcome', which is the foundation for CIF's proposed 'Customer First Duty'. This 'Customer First Duty' is very similar to the 'Best Interests Duty' applicable to financial advisers, which is the legislation Hayne references in the Final Report, although it is tailored to reflect how mortgage brokers operate.

The CIF is working towards having a Code of Conduct encapsulating this 'Customer First Duty' implemented by 2020.

Hayne Recommendations

Recommendation 1.3 – Mortgage broker remuneration

The borrower, not the lender, should pay the mortgage broker a fee for acting in connection with home lending. Changes in brokers' remuneration should be made over a period of two or three years, by first prohibiting lenders from paying trail commission to mortgage brokers in respect of new loans, then prohibiting lenders from paying other commissions to mortgage brokers.

Connective Position

Connective unequivocally reject calls to change the way mortgage brokers are remunerated.

The model for how mortgage brokers are paid is not fundamentally broken. There is always room for improvement – but regulators, government bodies, and the majority of consumer experiences all conclude there is absolutely no systemic misconduct in the mortgage broker industry.

Following the ASIC review in 2017, which was ASIC's largest ever data-driven investigation, ASIC concluded that it was not necessary to fundamentally change the commission model for mortgage brokers, because there was no systemic misconduct identified.

Similarly, Treasury in its submission to the Royal Commission, did not recommend any change to the way mortgage brokers are remunerated, cautioning against the potential for unintended negative consequences if the remuneration model were changed.

We seriously question whether the changes recommended by Hayne are necessary when no systemic misconduct has been found within the industry.

Rather than recommending sweeping change for the sake of change in every sector of financial services, we believe the existing laws and reform from CIF should be given a chance to have an impact.

What we're doing

We will continue to educate and advocate for brokers when it comes to mortgage broker remuneration.

We have been involved in developing the following recommendations via the CIF and do not believe any changes need to occur beyond these:

1. Changes to the standard commission model

- Current remuneration relates to loan size and the CIF recommends remuneration should be calculated on funds drawn down net of any drawn amounts deposited into an offset account. This removes one of the main conflict risks identified by ASIC regarding brokers recommending their consumers borrow more than they actually require.

2. Move away from volume-based and campaign-based commissions, and volume-based bonus payments.

- The industry ceased such payments from December 31, 2017, which has resulted in the reduction of conflict risk in product recommendations.

continued...

Connective Position

Change as recommended by Hayne will lead to the demise of competition and deny consumers a service they value, which is likely to eventually lead them back to the big banks.

Choice matters for all Australian home buyers and it has to be protected. Removing access to choice and competition in the home lending sector will simply hand more power and profits back to the major banks, which is exactly what Australians don't need.

What we're doing

3. Moving away from soft dollar benefits

- These reforms have been in place since December 31, 2017, reducing a potential broker conflict risk whilst ensuring any such benefits are aimed towards improving brokers' education and geared towards better customer outcomes.

Hayne Recommendations

Recommendation 1.4 – Establishment of working group

A Treasury-led working group should be established to monitor and, if necessary, adjust the remuneration model referred to in Recommendation 1.3, and any fee that lenders should be required to charge to achieve a level playing field, in response to market changes.

Connective Position

We support the establishment of a working group because we encourage testing the effectiveness of reform – accountability is critical – but we think the above recommendation will come too late in the process.

A working group should be established before any changes recommended by Hayne are implemented and it has to be representative of industry and subject matter experts.

We do not agree with Hayne's 'suck it and see' approach to adopting a new remuneration model for mortgage brokers and then using a working group to fix it. It is critical that time is provided to allow the impact of the CIF reforms to be measured appropriately before determining whether further reform is required.

In the ASIC review, ASIC recommended that they would re-examine the industry and data after a few years to observe whether any fundamental changes were required. We support and encourage this approach.

What we're doing

We have already called for ASIC to review the CIF's reforms for remuneration in two years to ensure they are working before determining whether additional reform is necessary.

We will continue to be an active participant of the CIF and industry groups representing brokers in any proposed reforms.

Hayne Recommendations

Recommendation 1.5 – Mortgage brokers as financial advisers

After a sufficient period of transition, mortgage brokers should be subject to and regulated by law that applies to entities providing financial product advice to retail clients.

Connective Position

We do not support this recommendation. It is important to maintain clear separation between credit assistance provided by mortgage brokers and finance advice provided by financial advisors. They are completely different roles with different requirements and responsibilities.

We also believe that if this recommendation is to be adopted then the NCCP Act would need to be amended.

Amending the NCCP Act is contradictory to recommendation 1.1 in the Final Report. The Royal Commission recommended making no change to the NCCP Act, indicating they found no fundamental flaw in it. So it is unclear to us exactly what Hayne is recommending.

We believe the better approach is to enshrine the 'Customer First Duty' or 'Best Interests Duty' (whichever is determined) into an enforceable code for the mortgage broking industry.

What we're doing

We'll continue to work with our customers and the industry to educate Australians and policy makers about the difference.

We will also continue our work with the CIF to create an appropriate code for the mortgage broking industry.

Hayne Recommendations

Recommendation 1.6 – Misconduct by mortgage brokers

ACL holders should: be bound by information-sharing and reporting obligations in respect of mortgage brokers similar to those referred to in Recommendations 2.7 and 2.8 for financial advisers; and take the same steps in response to detecting misconduct of a mortgage broker as those referred to in Recommendation 2.9 for financial advisers.

Connective Position

We absolutely support this recommendation – for us, it's business as usual!

We also back the calls for ASIC to have a broker register. We would like to see laws create a safe harbour for those who are responsible for reporting the misconduct.

Lack of clarity around compliance laws is holding the industry back from achieving more transparency. It is in everyone's interest to weed out the bad apples in the industry.

What we're doing

We already self-report bad broker behaviour to ASIC, industry bodies and lender partners, as appropriate.

We will terminate the membership of any broker found to have engaged in dishonest or fraudulent conduct. Our integrity and business success depends on us being transparent and proactive.

We pride ourselves on our commitment to continuously review and report inappropriate behaviour.

What happens now?

There is still uncertainty around what the final recommendations will look like and any real change is some time away. We will continue to work hard to stand by our broker network and the industry; we have your back now, tomorrow, and in the future.

We encourage you to pledge your support for mortgage brokers at #CHOICEMATTERS to help us send an impactful message to policy makers.

What we do know already is:

- The Royal Commission recommendations that will negatively impact brokers, will also have a knock-on effect to competition in the home lending market, and this will directly impact the hip pocket of all Australians.
- Removing the choice that mortgage brokers offer will only put more power and profits in the hands of the big banks, and remove access to smaller lenders.
- Connective has a full suite of products, services and support systems to protect brokers' businesses and help you grow in light of any potential change. We encourage you to access the full extent of our support and services during this time of change.
- We will continue to support our brokers by speaking on your behalf to influence change and future policy to achieve the best outcomes for all Australians.
- Actively participate in any activity that supports brokers.

PLEDGE YOUR SUPPORT

#CHOICEMATTERS

Mortgage brokers offer **value, service and choice.**

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Glossary

ASIC - Australian Securities and Investments Commission

ASIC Review - ASIC Report 516 - Review of mortgage broker remuneration March 2017

CIF - Combined Industry Forum

Final Report - Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry Final Report dated 1 February 2019

NCCP Act - National Consumer Credit Protection Act 2009 *(Cth)*

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