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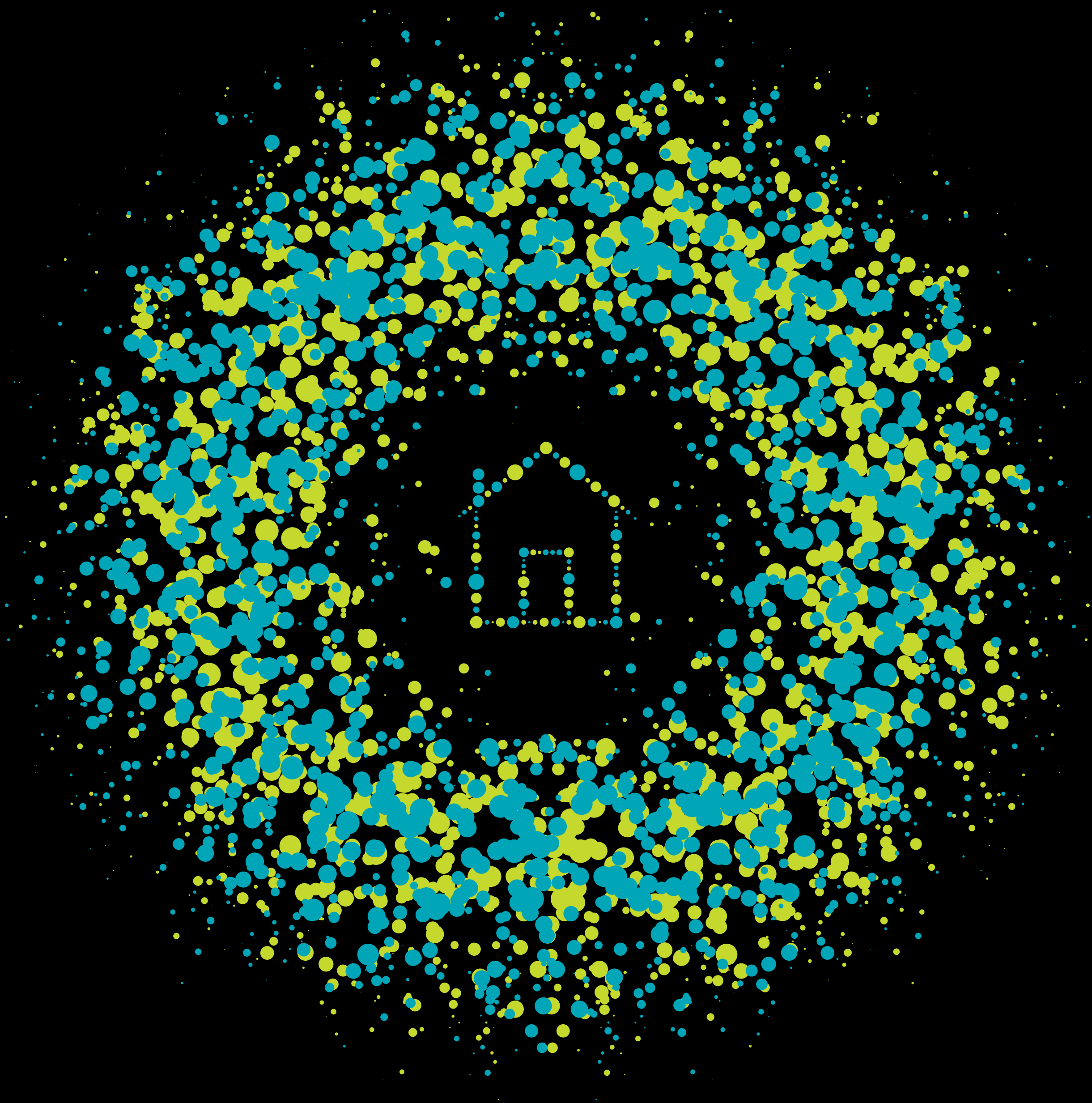

Finding focus in a complex market

Mortgage Report 2017

12th Annual Deloitte Australian Mortgage Report

In the Spotlight

In March 2017 ASIC announced its recommendations from its review of mortgage broker remuneration[1] to mixed reviews. The recommendations are generally in line with industry expectations, given ASIC's trend to ask for greater disclosure to customers from both lenders and broker groups.

Pleasingly, the review acknowledges the critical role that mortgage brokers play in the Australian mortgage market, in promoting competition, helping match individual customer needs to products, demystifying the house buying process and in guiding good customer outcomes. It also recommends a number of areas for improvement to ensure that the incentives framework does not drive unfavourable outcomes.

The review included 17 lenders, 15 aggregators, 55 brokerages, four comparison websites and three referrer aggregators, as well as meetings with stakeholders such as the Finance Brokers Association of Australia (FBAA), the Mortgage & Finance Association of Australia (MFAA), the Customer Owned Banking Association (COBA), the Australian Bankers Association (ABA) and the Australian Finance Conference (AFC).

The significant data requests from many of these stakeholders added to the delay in issuing the recommendations.

In summary, ASIC proposed the following recommendations to improve consumer and market outcomes:

- Recommended that the standard upfront/ trail commission model be revisited to reduce the risk of brokers seeking to inappropriately maximise their commissions by having the commission driven by total loan approved.
  - A suggested example is to link the commission to the LVR of the individual loan.
  - However it is important to note that the Review found that the current model was almost universal and the core commission model was still supported, albeit the link between commissions and total borrowings could be improved.
- Movement by the mortgage industry away from bonus commissions and payments, both to brokers and to staff at lenders.
- Move away from soft dollar benefits such as loyalty programs and generous 'perks' to brokers which can increase risk of poor customer outcomes and undermine competition.
- Clearer disclosure of ownership structures between lenders and aggregators to improve competition
- Implement a new public reporting regime of consumer outcomes and competition, to enhance the data available to assist in analysing the performance of lenders and individual brokers with regards to customer outcomes.
- Governance and oversight of both lenders and aggregators/ broker groups need to be enhanced to increase the focus on individual, as opposed to portfolio, customer outcomes.

ASIC noted that loans originated via brokers tended to be larger, with higher LVRs than direct-to-lender loans. Also it noted there is a greater proportion of interest only loans, even after taking into account the natural customer base of brokers, being those customers seeking to access the benefits of the broker distribution channel and its ability to advise them on navigating the market, across multiple products etc.

ASIC also acknowledged that the average broker consumer was two years younger than a direct-to-lender, and paid a lower average salary.

Additionally, ASIC noted that the key consideration in assessing customer outcomes is not the nature of the product per se (its IO, LVR, use of offset accounts etc), but rather the extent to which the product was suitable for the consumer. This of course will depend on the individual customer's requirements, objectives and circumstances.

Ultimately, the legal responsibility for concluding suitability rests with the lenders, though in today's world, the broker cannot absolve itself of the ethical responsibility for ensuring fairness of customer outcomes[2].

This review makes it clear that customer outcomes need to be at the forefront of broker minds, as well as monitored carefully by both aggregator and lender.

1. Report 516 - Review of Mortgage Broker Remuneration; released 16 March 2017 http://download.asic.gov.au/media/4184768/rep516-published-16-3-2017.pdf
2. See Page 21 Conduct Matters

The recommendation to implement a new public reporting regime, and to increase monitoring and oversight of origination activities will likely prove a challenge for both lenders and aggregators,

The new regime should cover:

- the remuneration received by aggregators and the potential value if all criteria for remuneration are satisfied
- the average pricing of home loans that brokers obtain on behalf of consumers
- the average pricing of home loans provided by lenders according to each distribution channel
- the distribution of loans by brokers between lenders to give consumers a better indication of the range of loans that brokers within the network offer.

Lenders are expected to:

- require aggregators, through their relevant commercial agreements, to actively monitor the consumer outcomes being obtained by brokers and broker businesses
- provide consistent reporting to aggregators to allow adequate oversight of brokers and broker businesses
- use a consistent process to identify each broker and broker business (e.g. use of the Australian credit licensee or credit representative number where relevant, or a unique number provided by the aggregator).

Aggregators are expected to:

- require lenders, through their relevant commercial agreements, to provide consistent reporting to the aggregator on the outcomes obtained by individual brokers and broker businesses, including those relating to loan pricing, features, clawbacks, and refinancing and default rates;
- actively monitor the consumer outcomes being obtained at a broker and broker business level, including those relating to loan pricing, features, clawbacks, refinancing and default rates, and distribution of loans among lenders; and
- retain this information in a way that can be provided to ASIC to allow us to review outcomes across the mortgage broking market

As ASIC notes in the review, the data challenges that exist when looking across the industry at both lender and aggregator level, and the comparability of data, will make the consistency of its expectations a challenge. This therefore will require considerable communication and agreement between lenders and aggregators, as well as cross industry views on what data points are relevant, accessible, historically available, and system supported.

We believe it will take some time to embed and require investment by all parties to reach an industry consistent level.

Additionally ASIC noted that the ownership structures of aggregator groups, by the major banks, particularly when assessed alongside white label arrangements, did have an impact on home loan flows, which could be seen as inhibiting competition.

We see the broker channel as an enabler of competition, particularly when the recent trend of focus on broker distribution by mid-tier lenders and mutuals is considered, and the recent growth of lenders such as CUA and ME is testament to this.

Removing the soft dollar benefits recommended by ASIC will assist this as it will continue to level the playing field and assist competition. It was noted in our panel, however that the back-office function efficiencies and consistency of application of underwriting policies will also be key for smaller entities continuing to focus on this method of distribution.

The industry is frustrated however by ASIC's intention to revisit the commission model in three to four years' time. Given the time taken to undertake this review, the data requirements and the desire by the industry to have a cohesive, market agreed approach for moving forward, it is unhelpful to perpetuate uncertainty around recommendations in the near future which could again change the model.

This proposal will continue to raise questions rather than provide clarity and a momentum to change.

Overall though our view is that the review is fair and supportive of the broker industry, acknowledging its critical role in enabling competition and in assisting consumers to their goal of home ownership. The recommendations were largely anticipated and embraced by the industry which welcomes the chance to demonstrate the benefits of its business model to consumers.

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