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Practice Group(s):

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Mortgage broker remuneration reforms – what you need to know

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Concerns have been raised by the Australian Government in recent times in relation to the effect of current remuneration structures in the mortgage broking market on the quality of consumer outcomes.

During 2016, the Australian Securities and Investments Commission (ASIC) was asked by Government to look into these structures and at the same time also looked at the governance and oversight arrangements within industry participants in relation to remuneration. During this same period, the Australian Bankers Association (ABA) was conducting a review into remuneration issues within retail banking. The ABA review was led by Stephen Sedgewick, former Australian Public Service Commissioner.

The ASIC report was released in March 2017 followed by the release of ABA's review in April 2017. There is consensus between these two proposals in relation to some of the key recommendations. If these key recommendations are adopted – which appears more likely than not – they will have a significant impact on the remuneration and business models of mortgage broker participants.

Treasury is seeking feedback on the ASIC report by 30 June 2017, after which time they will summarise their recommendations to Government. While there is no definite timeline on the introduction of these reforms it would not be unreasonable to predict a commencement date in 2019.

A comparison of the positions adopted by the ASIC and ABA reports, including a summary of some of the significant recommendations from both reports is outlined below.

ASIC Report Recommendations	ABA Report Recommendations
Commission	
1. Changing the standard commission model to reduce the risk of poor consumer outcomes. Note: For example, using LVR and other considerations such as compliance metrics in how upfront and trail commissions are calculated. Note: Lenders should not structure their incentives in a way that encourages the creation of larger loans that initially have large offset balances.	18. Banks adopt approaches to the remuneration of Aggregators and Mortgage Brokers that do not directly link payments to loan size and reflects a holistic approach to performance management. Note: Options for alternative payment arrangements could include: commission based payments that take the loan to value ratio (LVR) or the loan type, or the quality of the advice given to the customer into account; and, preferably arrangements between lenders, Mortgage Brokers and Aggregators that are not product based such as lender-funded fees for service. Trailing payments of some kind might continue (with existing trail commissions grandfathered). Any fees for service must be lender rather than customer funded.

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2. Moving away from bonus commissions and bonus payments, which increase the risk of poor consumer outcomes. Bonus commissions have raised concerns in other parts of the financial services industry and have been prohibited under the Future of Financial Advice (FOFA) reforms. Such prohibitions will also be extended to life insurance commissions.	16. (a) In respect of remuneration of Mortgage Brokers, Banks cease the practice of providing volume based incentives that are additional to upfront and trail commissions. 16. (c) In respect of remuneration of Mortgage Brokers, Banks cease the practice of increasing the incentives payable to Brokers when engaging in sales campaigns.
3. Moving away from soft dollar benefits, which increase the risk of poor consumer outcomes and can undermine competition.	16. (b) In respect of remuneration of Mortgage Brokers, Banks cease non-transparent soft dollar payments in favour of more transparent methods to support training etc.
Ownership Structure	
4. Clearer disclosure of ownership structures within the home loan market/distribution chain to improve competition and that these disclosures apply to lenders aggregators and brokers.	No equivalent recommendation.
Reporting	
5. Establishing a new public reporting regime of consumer outcomes and competition in the home loan market to report on: • potential and actual value of remuneration received by aggregators; • average pricing of home loans that brokers obtain; • average pricing of home loans provided by lenders according to distribution channel; and • distribution of loans by brokers between lenders.	18. (a) and (b) Banks with a significant presence in the Broker channel, and at least the four major banks, each report regularly to ASIC on their progress in relation to the governance of mortgage brokers with enhanced oversight by ASIC to monitor market responses. 15. The ABA commission an independent reviewer to report publicly in three years about how well banks have changed their practices and implemented the recommendations and assess whether further regulatory or legislative change is required. 19. The independent review proposed under Recommendation 15 or, at the latest, any post implementation review of the operations of the proposed product intervention power for ASIC, examine whether the government should legislate to extend ASIC's intervention powers to address conflicted remuneration in circumstances in which the industry cannot or does not address Recommendations 16, 17 and 18 adequately without such an intervention.

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Broker Oversight	
6. Improving the oversight of brokers by lenders and aggregators. **ASIC expect lenders to:** (a) require aggregators, through their relevant commercial agreements, to actively monitor the consumer outcomes being obtained by brokers and broker businesses; (b) provide consistent reporting to aggregators to allow adequate oversight of brokers and broker businesses; and (c) use a consistent process to identify each broker and broker business (e.g. use of the ACL or credit representative number where relevant, or a unique number provided by the aggregator). **ASIC expect aggregators to:** (d) 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; (e) 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 (f) retain this information in a way that can be provided to ASIC to allow it to review outcomes across the mortgage broking market.	17. Banks adopt, through negotiation with their commercial partners, an 'end to end' approach to the governance of Mortgage Brokers that approximates as closely as possible a holistic approach broadly equivalent to that proposed for the performance management of equivalent retail bank staff. Note: A scorecard would meet this recommendation but is not the only viable approach. This recommendation is addressed to each bank individually, but particularly to the largest banks and to banks with an ownership interest in an Aggregator (i.e. vertically integrated).

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What should Lenders and Brokers be doing next?

With the release of their report, ASIC have announced that they will be conducting a targeted review of the suitability of advice provided by brokers commencing this year. Participants in the mortgage broker market should be prepared to respond to possible ASIC requests for documentation and access to information.

Additionally, the ASIC report notes that the ABA review provides an opportunity for the banking industry to act on the ASIC report proposals 1, 2, and 3 (above) prior to the passage of any legislative reform package and industry participants should be considering adjustments to their business models ahead of any mandatory changes.

Finally, as noted above, while there are certainly relevant differences, there are a number of elements of the recommendations contained in both the ASIC report and the ABA review which already underpin key aspects of the FOFA reforms in the financial advice industry. Participants in the mortgage broking sector may want to look at the market responses to FOFA reforms to get some indication of how the key recommendations for mortgage broker remuneration may play out.

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