

**Royal Commission into Misconduct in the Banking, Superannuation and
Financial Services Industry
Australian Finance Group Ltd Submission
6 March 2018**

Invitation to make an early written submission

Thank you for giving AFG the opportunity to make an early written submission to the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry (the **Commission**).

Background

Australian Finance Group Ltd (**AFG**) is not a subsidiary of a bank but is independently owned and operated and was listed on the Australian Securities Exchange on 22 May 2015.

AFG provides aggregation services to approximately 2,900 brokers (including 1,194 individual credit representatives and 850 corporate credit representatives). We describe all of these brokers as AFG's "affiliated brokers".

AFG has prepared its responses with respect to its activities as an aggregator. Responses involve both credit representatives of AFG (for which AFG has additional responsibilities under the *National Consumer Credit Protection Act 2009*) and brokers operating under separate Australian Credit Licences.

AFG previously operated a financial planning business through a subsidiary company (formerly AFG Financial Planning Pty Ltd). That company was sold in 2009 and became part of the Sentry Group of companies (which is not related to or associated with AFG). Relevant books and records for that company were transferred to the Sentry Group at the time of the sale. As a result, this submission does not contain information about AFG Financial Planning Pty Ltd.

The aggregation services provided by AFG include:

- contractual arrangements with approximately 45 lenders which comprise AFG's lending panel (AFG's affiliated brokers are able to submit or refer loan applications to lenders on AFG's panel subject to the individual broker also being accredited by the lender to do so);
- IT systems for the introduction or referral of loans to lenders (information is captured through AFG's IT systems and compliance documents such as privacy consents, credit guides and credit proposals are generated);

- collection and distribution of payments from lenders;
- compliance and marketing support services.

As a provider of aggregation services, AFG does not deal directly with consumers. Instead AFG sits between the broker (who deals directly with their client) and the lender. AFG also has additional responsibility and liability for the acts of its credit representatives who, under the *National Consumer Credit Protection Act 2009*, provide credit assistance on AFG's behalf.

Brokers have a fundamental obligation under the *National Consumer Credit Protection Act 2009* to make a preliminary credit assessment before suggesting a credit product to a consumer. This is different from the final credit assessment that must be conducted by the lender. Paragraphs 3.5, 3.66 and 3.67 of the Explanatory Memorandum to the *National Consumer Credit Protection Act 2009* provide a useful summary of the differences.

3.5 The key obligation for licensees is to ensure they do not provide, suggest, or assist with a credit contract that is unsuitable for the consumer. This obligation requires licensees to reasonably inquire and verify a customer's financial circumstances to make an assessment that the credit contract will meet the consumer's requirements and that the consumer has the capacity to repay the contract.

3.66 The purpose of the credit assistant's preliminary assessment of unsuitability is to ensure that credit assistants do not suggest to consumers (or assist consumers to apply for) credit contracts that they do not reasonably believe meet the consumer's requirements and objectives and reasonably believe that the consumer has the capacity to repay the contract without substantial hardship.

3.67 In contrast to an unsuitability assessment made by a credit provider for the purposes of entering a consumer into a credit contract, an unsuitability assessment made by a credit assistant is considered to be a 'preliminary' assessment based on the information available to a credit assistant. This does not diminish the credit assistant's responsibilities with regard to making reasonable inquiries and undertaking reasonable verification of the information they can access. However, it recognises that the credit assistant does not have access to some information that is available to a credit provider (such as credit bureau data and data arising from a banking relationship) and that a credit assistant is not making an assessment that takes into consideration the commercial risk of being the lender.

The Explanatory Memorandum acknowledges the differences between the roles and responsibilities of brokers (i.e. credit assistants) and lenders (i.e. credit providers) and, most importantly, recognises that a broker's access to information is necessarily limited to the information that the consumer supplies and publicly available information.

Similarly, aggregators such as AFG rely heavily on information provided by lenders in order to identify misconduct. It is often through the lender's process of conducting their own final credit assessment (including making the lender's own reasonable inquiries and reasonable steps to verify the consumer's financial situation) that the lender is able to identify differences between the information provided by the broker and their own inquiries. This is vital intelligence and, when such information is passed on, enables AFG to conduct focussed investigations where there is an identified risk of misconduct.

Questions 1 and 2: Identified misconduct and conduct falling below community standards and expectations

AFG has identified some conduct which it considers may constitute "misconduct" or conduct which has "fallen below community standards and expectations" as referred to by the Commission. Please refer to Annexure 1 for details of this conduct.

Question 3: Further information requested in respect of identified conduct

Question 3 of the Commission's letter seeks various further information in relation to the conduct that AFG has identified which may constitute misconduct or conduct falling below community standards and expectations. The further information the Commission has requested in respect of that conduct is set out in Annexure 1.

AFG also makes the following additional remarks in relation to information requested by the Commission.

Steps to prevent future misconduct

On average, AFG's affiliated brokers submit more than 9,000 applications for home loans to lenders each month. When an allegation of possible misconduct is received, or a suspicion of possible misconduct is formed by AFG, AFG investigates the matter and takes appropriate action. The action may include termination of AFG's contractual arrangements with the broker (i.e. ceasing to act as the broker's aggregator), suspension, increased supervision (including additional audit reviews), training, and remedial action for affected clients (which may include compensation).

AFG has a team of compliance officers who assist AFG to meet legal and regulatory requirements including identifying and investigating allegations of broker misconduct. AFG's compliance officers report to AFG's Head of Risk and Compliance and do not have reporting lines to sales or operations managers. The remuneration of Compliance Officers is not linked to broker profits. These structures are designed to promote the independence of Compliance Officers and ensure that they are able to carry out their function as gatekeepers.

Each individual credit representative of AFG is subject to not less than an annual review. These reviews are undertaken by AFG's team of compliance officers.

The compliance officer selects files to be reviewed from applications for finance lodged by the credit representative in the period since the last review. Files are currently selected based on risk criteria which may include factors such as interest only, high loan to valuation ratio or non-conforming lender.

The compliance officer provides a report to the credit representative about the results of the audit and highlights, both in a telephone conversation and in the audit report, areas for improvement and any areas of concern. Education and training are provided to assist the credit representative to make necessary improvements. Areas identified as requiring improvement are also monitored in subsequent reviews.

If potentially serious concerns are identified, further investigation will be undertaken. Various consequence management options are considered when an audit reveals more serious issues. Options that are considered include remedial action, rectification, additional education and training, more frequent audit reviews (which may be increased to every 3 or 6 months), suspension and/or termination.

Compliance officers also investigate concerns raised by AFG's panel of lenders with respect to broker conduct and apply AFG's various consequence management options (listed above) as appropriate.

AFG's Complaints Officer investigates consumer complaints in accordance with AFG's Dispute Resolution Policy which is designed to assist AFG to deal promptly and fairly with individual complaints and identify any systemic issues and trends.

All credit representatives are required to undertake 20 hours of continuous professional development each year and provide AFG with details of the training they have undertaken. In addition, AFG's compliance team run compliance training twice each year which all credit representatives are expected to attend.

AFG also provides its credit representatives with online training modules that can be accessed at any time as well as individual support (as required) from AFG's compliance team. AFG is well progressed in the development of a number of enhancements to the online training system which will make it easier for AFG to monitor whether credit representatives have undertaken required training and, through integrated testing, ensure that they have understood the materials.

AFG is also well progressed in the development of a broker scorecard that will assist AFG to better identify brokers who may require additional training and/or a higher level of monitoring and supervision. The broker scorecard will use technology to sort and analyse

information held electronically in AFG's systems to identify activities that fall outside of set parameters.

Inquiries, investigation, criminal or civil proceedings

AFG is not currently involved in any criminal or civil proceedings with respect to the matters described in Attachment 1. Nor is AFG aware of any current inquiry or investigation with respect to any particular matter.

Culture or governance of AFG

While AFG has not attributed the identified misconduct to failings in AFG's culture or governance, AFG believes that it is essential to continue to work to improve its monitoring and supervision of brokers in order to better and more quickly identify practices that may not meet community expectations as well as instances of misconduct; so that they can be effectively actioned and remediated.

Industry or sector culture or governance

AFG accepts that the ASIC Review of Mortgage Broker Remuneration has identified areas that require improvement in order to better equip the industry to meet community expectations. AFG is committed to working with the Combined Industry Forum to make improvements to address the areas of concern.

Continuing work to meet community expectations

The mortgage and finance industry is relatively young and has been through significant developments since 2008, particularly since the introduction of licensing, training and education standards, responsible lending obligations, compulsory dispute resolution processes, and regulation by ASIC. AFG acknowledges that these changes to the regulation of mortgage brokers were the result of failures by the industry to always meet community expectations.

More recently, in February 2016 the Australian Securities & Investments Commission (**ASIC**) issued the *Review of Mortgage Broker Remuneration Structures Scoping Discussion Paper* (the **Scoping Paper**) which notes that the Government had requested ASIC to conduct the review to determine the effect of current remuneration structures on the quality of consumer outcomes.

Following an unprecedented data collection process, ASIC released *Report 516: Review of mortgage broker remuneration* in March 2016 (**ASIC Report 516**). That report recognises

the important role that mortgage brokers can play in promoting good consumer outcomes and strong competition in the home loan market.¹

In the report ASIC put forward 6 proposals to improve consumer outcomes and competition in the home loan market. ASIC stated that the proposals are to “strengthen the positive contribution that brokers provide in this sector”² while enhancing:

- (a) consumer outcomes and competition;
- (b) the operation of the home loan market more generally; and
- (c) the trust and confidence that consumers have in brokers.³

AFG acknowledges that failure to act on ASIC’s proposals to improve consumer outcomes and competition would be a failure to meet community standards and expectations and, as part of the industry working party known as the Combined Industry Forum (**CIF**), has worked to develop a package of reforms designed to improve consumer outcomes and confidence in the finance industry. The CIF has issued a report to the Federal Government in response to ASIC Report 516 setting out the proposed reform program. In summary:

This reform package includes the following key features:

- Implementation of an improved data driven governance framework that is self-assessing, self-correcting and continuously improving;
- Recognition of the potential conflicts of interest and risk of poor customer outcomes as a result of bonus commissions and volume bonus payments;
- Recognition of the potential conflicts of interest and risk of poor customer outcomes as a result of targeted lender campaigns based on increased commissions paid to the mortgage broker, rather than increased value and service for the customer;
- Recognition of the risk of poor customer outcomes as a result of financial incentives that may encourage customers to borrow more than they need. The industry considers that lenders may address this risk by adopting a principle that, to the extent that remuneration relates to loan size, it should relate to the funds drawn down and utilised by a customer. This would be satisfied where, for example, upfront commission was paid on the balance of borrower funds drawn down and utilised by the customer, net of offset accounts or redraw facilities;
- Volume based ‘broker clubs’ to transform to tiered service models that deliver better standards of service for the customer and do not further reward the broker;

¹ Australian Securities & Investments Commission, *Report 516: Review of mortgage broker remuneration*, March 2017, para 19.

² *Ibid*, para 23.

³ *Ibid*, paras 23-24.

- A new regime for controlling and disclosing non-monetary benefits that manages lender choice conflicts and emphasises professional development and relationship building that promotes competition;
- A clear disclosure regime for ownership structures that takes owner influence into account and provides customers with the information they need to make informed choices; and
- A range of effective and achievable disclosure and public reporting measures to help track customer outcomes, broker behaviour and overall mortgage and finance industry performance.⁴

AFG intends to continue to work with CIF on the implementation of the package of reforms.

Question 4: RSE licensees

Question 4 of the Commission's letter seeks further information in respect of entities that are, or have a connection to, RSE licensees of a registrable superannuation entity. This question is not applicable to AFG as AFG is not, and does not have a connection to, an RSE licensee.

Other matters

AFG has encountered a number of challenges in seeking to respond to the Commissioner's request including the potential breadth and ambiguity in one or more of the questions, the 10 year time period covered by the request and AFG's role as a provider of aggregator services (including accessing relevant information held by banks and other lenders). AFG requests that these challenges be borne in mind when considering its response.

⁴

Combined Industry Forum, *Improving Customer Outcomes: The Combined Industry Forum response to ASIC Report 516: Review of mortgage broker remuneration*, December 2017, p4.