ROYAL COMMISSION INTO MISCONDUCT IN THE BANKING, SUPERANNUATION AND FINANCIAL SERVICES INDUSTRY

SUBMISSIONS OF ZIPPLER PTY LIMITED IN RESPONSE TO THE INTERIM REPORT HOME LOANS (CONSUMER FINANCE)

1. Zippler Pty Limited (**Zippler**) is an Australian Credit Licensee and fintech.

2. Through its cloud served platform, SmartApply (**SmartApply**), Zippler has provided an active, independent compliance service to third party mortgage brokers since June 2016.

3. Zippler is not aligned with any lender, aggregator or mortgage broker[1]. Although Zippler is independent within the meaning of s160B of the *National Consumer Credit Protection Act 2009* (Cth) (the **Act**), the third-party, commission reliant brokers using SmartApply are not.

4. In the Interim Report the Royal Commission expressed concerns about the impact of mortgage brokers' commissions on consumer outcomes including:

    a. higher leverage/higher LVR's;

    b. higher incidence of interest only loans;

    c. higher total debt to income ratios; and

    d. higher interest costs.

5. The technology-based compliance system offered by Zippler has a demonstrated capacity to address those harms while still allowing commissions to be paid.

6. Clients of brokers using SmartApply - which costs $198 per loan audit –amongst other benefits, have on average significantly:

    a. lower leverage/lower LVR's;

    b. lower incidence of interest only loans; and

    c. lower interest costs,

    when compared to ASIC's published findings for broker and non-broker consumers following its Review of mortgage broker remuneration (**ASIC Report 516**)[2].

[1] To assist SmartApply development, Zippler has from time to time operated a part-time, independent - as defined by section 160B (2)(b) of the Act - mortgage broker.

[2] Australian Securities and Investments Commission March 2017 Report 516.

7. Total debt to income ratio is not reported due to uncertainty of methods used in ASIC's calculations, however SmartApply results and practice suggest this may also be lower for clients of brokers using SmartApply.

8. The Royal Commission could therefore consider the need to mandate the use of technology-based active, independent compliance services such as SmartApply, as a means of rapidly ameliorating consumer outcomes with minimal disruption, cost or risk of eroding the positive consumer benefits of a well-regulated mortgage broking industry.

9. Zippler has identified aspects of its experience in coming to solutions that it considers may assist the Royal Commission and additionally makes the following submissions in response to certain other questions raised during hearings and in the Interim Report concerning:

    a. Remuneration:

        i. How, if at all, is the remuneration of intermediaries associated with misconduct in connection with home loans?;

        ii. Is there a way to solve the remuneration of intermediary's problem?

    b. For whom does the intermediary act and in particular:

        i. What duties does/should an intermediary owe to a borrower?

        ii. Is it desirable to have mortgage brokers act in the best interest of the borrower?

<u>Active Independent Compliance Services – an opportunity to improve systems.</u>

10. There are several influential characteristics of the lending and specifically mortgage broker ecosystem that commonly, if not universally, lead to consumer disadvantage and poor outcomes and which can be readily mitigated or eliminated by active independent compliance systems. They are:

    a. All industry side participants, lenders, aggregators and mortgage brokers are equally conflicted between maximising profit/earning a living and what is in the best interest of consumers;

    b. Unusually vague legislative control in key areas;

c. A broken and inconsistent data chain from the consumer's initial enquiry through to their final outcome;

d. High opacity of key data and conduct of all actors at an individual and collective level;

e. A lack of dynamic monitoring and/or appropriate response;

f. Productivity risk of additional regulatory change and risk that it may marginalise competition exacerbating current issues faced by consumers; and

g. A strong propensity for all participants from consumers to regulators to act on good faith.

11. Well-designed compliance services can play a key role in enhancing accountability in addition to detecting, avoiding and mitigating potentially poor consumer outcomes to further enhance benefits offered by and productivity of the mortgage broker sector.

SmartApply – An operational example of an active independent compliance service.

12. Since late 2016, Zippler has provided third-party brokers an active, independent compliance service through SmartApply comprising:

    a. A comprehensive engagement and workflow platform incorporating proprietary backend methods that:

        i. Is the central interaction platform for the consumer and mortgage broker from initial enquiry through to loan settlement or decline;

        ii. Manages and assists all key stages including Discovery and solution design; Broker loan comparison and pricing; Consumer loan comparison and selection; Loan application preparation; Compliance document preparation; Supporting document collection; Lender submission; Scenario audit; Approval and settlement; and Commission and loan amortisation management (subject to aggregator/lender access);

        iii. Captures, stores, tracks, and reacts to inputs for all loan enquiries;

        iv. Includes an anonymous mortgage contest module for brokers offering an independent, impartial or unbiased service that – consistent with section 160B (2)(b) of the Act - mitigates direct and indirect restrictions by enabling non-commission paying lenders to individually quote/compete for the client's loan directly within product comparisons alongside the brokers conventional lender panel[3];

v. Automates compliance; consumer best interest measures; and audit;

vi. Can interact with conventional aggregator, mortgage broker; lender and regulator platforms and apps via API; and

vii. Is accessible to lenders and regulators on an individual scenario basis where integration is undesirable or uncommercial.

b. A manual, independent expert Application Audit for all loan applications upon submission, which is conducted in parallel to lender submission, thereby avoiding delays to the approval outcome and includes:

i. Review of automated audit results;

ii. Presence, consumer acknowledgement and completeness of compliance documents;

iii. Consistency between feature selection and consumer best interest;

iv. Consistency between lender selection and consumer best interest;

v. Compliance with lender credit policy;

vi. Supporting documentation inconsistency and/or provenance concerns;

vii. Areas of concerning data/data transformation;

viii. Broker omissions and oversight; and

ix. Platform efficacy and continuous development.

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[3] A lender panel is the range of lenders with which the broker can arrange a loan.

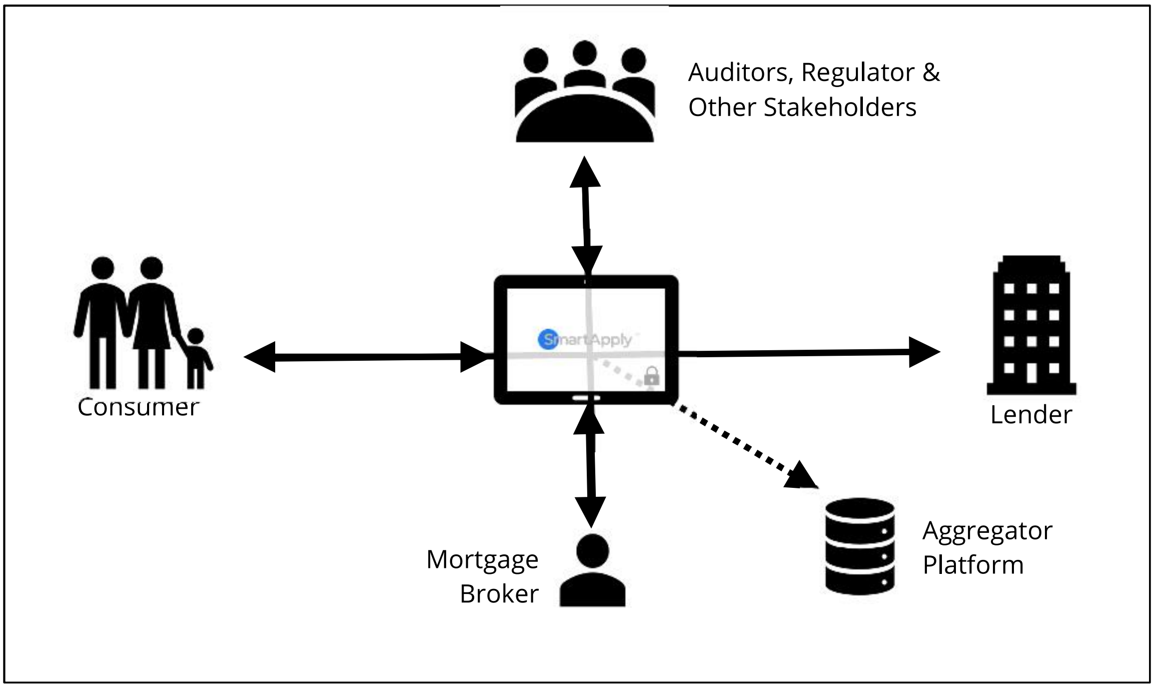

Figure 1 - SmartApply is the central platform for broker/consumer interactions delivering full cycle transparency for auditors, regulators and the receiving lender.

SmartApply Results:

13. ASIC Report 516 summarised certain loan characteristics for broker and non-broker loans[4] as shown in the table below.

14. Applying the same metric to all loans settled by all brokers using SmartApply[5] gives the figures in the right-hand column:

Mean	ASIC Report 516		SmartApply
	Brokers	Non-broker	Brokers
Direct Average of LVRs (Leverage)	75%	70%	62.96%
Interest-only loans (as a percentage of total loans)	29%	17%	8.35%

15. SmartApply data[6] also reveals that average interest rates for the loans settled with the platform were significantly (typically 0.63% p.a.) lower than the major bank's discounted

[4] Australian Securities and Investments Commission March 2017 Report 516 p15.

[5] For period 1 July 2016 to 30 June 2018.

[6] SmartApply Data for the period 1 July 2016 to 30 June 2018, excludes Fixed Rate and Introductory Rate Loans. Comparisons made against averages of the relevant major bank interest rates published at the time of comparison by the broker.

interest rates for essentially equivalent loans. This is due in part, to SmartApply facilitating the mitigation of lender choice conflict, thereby prioritising lower priced lenders and loans which meet or exceed the consumer's needs.

16. While conventional mortgage brokers refer 66%[7] of loans to preference higher priced major banks, third-party brokers using SmartApply placed only 9.86% of loans with major banks. This allocation comprises 3.55% of settled loan by value placed with the major banks' premium brands (i.e. ANZ, CommBank, NAB or Westpac) and 6.31% to their discount brands which include BankWest, BankSA and St George.

17. It is worthwhile noting that, as compliance is broadly viewed by industry as an overhead, Zippler has focussed its industry-side marketing for SmartApply on efficiency and automation which, though underpinning enhanced compliance, has demonstrably improved productivity and therefore profitability for third party brokers.

18. Productivity results for a control sample of brokers with several years prior experience and where pre-implementation data was available appear below.

	Per Broker Per Calendar Month			
	Applications Lodged		Settlements	
	Average	Peak	Average	Peak
Client/Aggregator System (FY16)	5.96	12	4.52	11
With SmartApply (FY18)	9.85	33	6.69	20

Challenges facing Active Independent Compliance Services.

19. ASIC estimates $720b in new and outstanding home loan balances in 2015, generating significant profits to lenders and a further $2.402b in mortgage broker commissions[8].

20. In contrast, market wide implementation of independent compliance services such as SmartApply to both mortgage broker and lender direct originated loans will likely cost industry less than $150m. Implementation of an independent compliance service could be realised across the entire mortgage broker sector in 6-12 months and extended to direct

[7] Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry :- Background Paper 2: Some Features of the Australian Mortgage Broker Industry p14.

[8] Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry :- Background Paper 2: Some Features of the Australian Mortgage Broker Industry p15, p16.

lenders, thereby encompassing all property-based financing in a further 6 months - if lenders, aggregators and mortgage brokers were genuinely inclined to do so.

21. However, notwithstanding productivity improvements, most brokers, even among existing SmartApply subscribers remain somewhat resistant to independent expert Application Audit and the unusually high degree of accountability that systems such as SmartApply introduce.

Existing Regulation – consumer friend or foe?

22. The Act currently provides foundational legislation supporting the use of active independent compliance services.

23. Section 47 of the Act states:

> … (1) A licensee must:
>
> … (b) have in place adequate arrangements to ensure that clients of the licensee are not disadvantaged by any conflict of interest that may arise wholly or partly in relation to credit activities engaged in by the licensee or its representatives….
>
> … (2) For the purposes of paragraphs (1)(b), (g), (k) and (l), in considering whether a matter is adequate, the nature, scale and complexity of the credit activities engaged in by the licensee must be taken into account.

24. This section of the legislation is hogtied - particularly in the present, widespread industry cultural settings - by a lack of clear, enforceable definition:

    a. For the purpose of (1)(b) - what is meant by adequate; and

    b. For the purpose of (2) – the measurements and thresholds that trigger redefinition of “adequate” for the purpose of (1)(b).

25. The challenges facing consumer protection due to section 47 is best summarised by the following questions: -

> Is it ‘adequate’ that lenders and brokers, can lawfully avoid an active independent assessment system that could identify and mitigate conflicts?
>
> In the case of a $400,000 home loan, a lender might earn $4,000 to $8,000 a year and a mortgage broker might earn $6,000 over 5 years.

For the consumer, the loan is likely to be one of the largest financial decisions they have made. They are placing a significant amount of trust in the broker.

Conflicts of interest could foreseeably cause that loan to cost the consumer $3,000 a year more than it should. This may happen without the consumer's knowledge and will erode the consumer's ability to build a repayment buffer. This in turn could trigger financial distress or collapse for the consumer.

A technology based active independent assessment system could identify conflicts at a cost of $198.

If these systems are not 'adequate arrangements' what is appropriate, and at what thresholds should adequate arrangements be monitored and enforced?

26. In view of the relatively minor cost and wide accessibility to solutions, the Royal Commission could therefore consider the need to mandate the use of technology-based active, independent compliance services such as SmartApply for all residential mortgage lending or alternatively for all transactions above a nominal amount.

Remuneration - How, if at all, is the remuneration of intermediaries associated with misconduct in connection with home loans?

Remuneration based conflicts of interest.

27. Consistent with ASIC Report 516, conflicts of interest fall broadly into two categories:
    a. lender choice conflict; and
    b. product strategy conflict.
28. However, conflicts of interest are more complex and difficult if not impossible to mitigate merely though remuneration changes than is commonly believed. Consequently, attempts to eliminate or mitigate conflicts are oversimplified and deliver limited or no improvement – as demonstrated by the approach of Mortgage Choice discussed shortly. This is because, under most success-based supply side remuneration models, mortgage brokers remain conflicted in the following ways:
    a. Return on investment – This lender choice conflict is potentially the most significant conflict potentially affecting a broker's advice. It arises as different lenders require brokers to expend more effort:

i. "Selling the brand";

ii. Researching the product;

iii. Verifying credit policy compliance/suitability prior to recommendation;

iv. Gathering and collating required proofs;

v. Interacting with the lender to achieve approval/settlement; and

vi. Managing the consumer.

b. Risk/certainty of remuneration – This lender choice conflict together with return on investment drivers are demonstrably the most influential on broker behaviour. This conflict arises as certain lenders:

i. Including some ADI's, are lesser known and consequently less trusted by consumers ergo the consumer may be less likely to proceed with a given lender despite loan approval even where that lender has a cheaper, but essentially identical offering;

ii. Operate stricter credit policy which:

a. Requires consumers to expend more effort collating proofs than others; and/or

b. Means the consumer is less likely/certain of loan approval; and

iii. Have a more protracted and/or individual the loan approval process;

c. Volume based remuneration/volume based renumeration over time – This product strategy conflict can arise where larger loans and/or protracted principal repayment create increased cost and risk for consumers while producing increased income for mortgage brokers, aggregators and lenders.

<u>Lender choice conflicts</u>

29. Lender choice conflict has the single broadest and most far reaching implication to consumer and market-wide outcomes. Unmitigated, it can and often does lead both consumers, whether or not they use a mortgage broker and mortgage brokers themselves to generally preference major lenders with already strong market power that charge higher interest rates to maintain higher profit margins.

30. For the consumer, higher interest rates:

a. increase the cash flow/repayment pressure upon them;

b. limit their ability to build repayment buffers;

c. limit their ability to repay their loan early and increases their interest costs and time spent at risk overall.

Without adequate mitigation this conflict can directly and markedly affect all consumers who use a mortgage broker, however it also affects those who do not by potentially reducing competitive tension.

31. In June 2018, the Productivity Commission confirmed the wide held view - one which Zippler supports - that continued viability of the mortgage broker is contingent on continuity of supply side remuneration, reporting that[9]:

    a. "Deloitte (2016a) found that 37% of surveyed broker customers were not willing to pay mortgage brokers a fee. Of the 63% that were, 22% were only willing to pay up to $500, and a further 18% were only willing to pay up to $1000. Focus groups revealed that most consumers would not pay, and would instead approach lenders directly."; and

    b. "The Commission agrees that fees for service paid by consumers are unlikely to be pro competitive, because a lack of willingness to pay is likely to result in a smaller mortgage broking industry, and the greater damage would be to the lenders without branch networks. Given that many mid size and smaller lenders rely on brokers to compete (section 11.3), competition in the home loan market would likely be weaker as a result."

32. While supply side remuneration can appear problematic, the sole conflict of interest arising from supply side pricing which is <u>not</u> strictly prohibited by the Act or the National Credit Code, occurs through each lender's willingness to make commission payments and particularly individual lender's payment generosity (**commission rate variability**). Within a mortgage broker's panel, commission rate variability is likely if not certain.

33. When commission rate variability is inconsistent with the advantage or disadvantage to the consumer, it is rightly considered as a conflict of interest suffered by the broker. Moreover, due to its obvious nature, commission rate variability is often regarded as the major conflict that, left unmitigated, will adversely affect the broker's advice and

[9] Competition in the Australian Financial System:- Productivity Commission Inquiry Report No.89 p148, p333

subsequently the borrower's outcome. For some, this raises the belief that levelling supplier side payments may go some way toward if not altogether eliminating lender choice conflict. By way of testing this belief, Zippler submits that the approach of Mortgage Choice should be examined.

34. Mortgage Choice is a retail branded aggregator which has promoted and supported a national network of Mortgage Choice broker franchises throughout Australia since the 1990's. Mortgage Choice has, since its inception, equalised commissions received by its brokers by paying them the same rate regardless of which lender the loan is placed with.

35. Using this equalisation method, Mortgage Choice reports that 69% of loans it brokered in the first half of FY2013[10] were placed with major banks (52%) and subsidiaries including St George and Bankwest (17%). Mortgage Choice reports this fell to 62% in FY2017[11] with 47% brokered to major banks and 15% to subsidiaries.

36. This lender/loan apportionment and trend is broadly consistent with the Mortgage & Finance Association of Australia (**MFAA**) industry wide statistics that reported the proportion of loans brokered with major banks and owned or aligned regional banks was 74.3% in the three months September 2013 falling to 66% in the three months to March 2017[12].

37. The dominance of the major banks, particularly their premium brands is somewhat at odds with consumer best interest. Rates offered by the major bank's premium brands are seldom competitive. The Australian Consumer Competition Commission supports this observation, stating "they do not seek to compete by consistently offering the lowest headline rates, but instead aim to achieve a 'mid-market' position or broadly align their headline rates with the other big four banks"[13].

38. These results demonstrate that in the Australian marketplace, equalisation of broker remuneration across lenders has minor, if any effect on lender choice conflict. Further, if

[10] Mortgage Choice Limited Half Year Results Ending 31 December 2013 p17.

[11] Mortgage Choice Limited FY17 Full Year results presentation p19.

[12] Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry :- Background Paper 2: Some Features of the Australian Mortgage Broker Industry p14.

[13] Productivity Commission Inquiry into Competition in the Australian Financial System - ACCC submission in response to the Draft Report sub. DR129, p2).

lender choice conflict is causing adverse outcomes, Risk/certainty of remuneration and/or Return on Investment conflicts are more likely the cause.

39. Conversely, third-party brokers using SmartApply placed 9.86% of loans with major banks. This allocation comprises 3.55% of settled loan by value placed with major bank premium brands (i.e. ANZ, CommBank, NAB or Westpac) and 6.31% to their discount brands, which include BankWest, BankSA and St George.

40. Taken overall, MFAA, Mortgage Choice and SmartApply data demonstrate that:

    a. Lender choice conflict is more complex than variability of different rates of commission between lenders;

    b. Lender choice conflict caused by supply side remuneration including commission rate variability is substantially altered for commission-based mortgage brokers who operating with an active, independent compliance system;

    c. An active independent compliance system is also more likely to overcome Risk/certainty of remuneration and/or Return on Investment conflicts both of which, in a well-regulated environment, can be mitigated;

    d. Mortgage brokers that mitigate lender choice conflict can deliver consumers lower interest rates ergo reduced interest cost and significantly increase competitive tension by further diluting individual lender market power;

    e. The current arrangements to ensure that clients of mortgage brokers are not disadvantaged by any conflict of interest, including commission levelling strategies appear to produce inferior consumer outcomes; and

    f. Lender choice conflict can be mitigated to enhance competition and consumer outcomes by moving compliance management from the chain of conflict to an independent system with little or no adverse downstream risks to mortgage brokers which may be posed by further regulation restricting or affecting the current remuneration mortgage broker remuneration model.

<u>Product strategy conflicts</u>

41. Product strategy conflict occurs when the product and/or strategy, including degree of consumer leverage, increases the risk of poor consumer outcome while causing the

mortgage broker to earn increased income. These conflicts arise because of two key characteristics of the longstanding mortgage broker remuneration model:

a. Volume based remuneration whereby larger loan amounts produce higher risk for the borrower while producing higher income to the broker; and

b. Trail Commissions whereby the broker receives monthly payments from lenders which are volume based.

42. Product strategy conflict occurs in all cases where a broker is providing consumer guidance on:

    a. Interest rate type – Fixed versus variable rate as fixed rates include potentially punitive early payment fees helping to ensure low-fuss continuity of trail commission while also creating certainty of refinance discussions as the fixed rate approaches maturity;

    b. Repayment type – Principal and Interest versus Interest only; and

    c. Borrowing capacity and/or loan amount.

43. There is no doubt that volume-based remuneration and/or volume based renumeration over time characteristic of conventional Upfront and Trail Commission models can, in the absence of sound compliance practice and monitoring, lead to higher incidence of characteristics associated with poor consumer outcomes, including higher incidence of interest only loans, higher leverage and higher interest costs.

44. However, it is noteworthy that consumers using third-party brokers that have adopted SmartApply demonstrate significantly lower incidence and degrees of these characteristics than both broker and non-broker consumers as reported in ASIC Report 516, suggesting two possibilities:

    a. The risk posed by existing Upfront and Trail Commission models can be mitigated by mandating the use of active independent compliance services like SmartApply; and

    b. The reasons behind brokered loans producing higher incidence of interest only loans, higher leverage and higher interest costs may not be directly related to the volume/time-based nature of existing Upfront and Trail commission models.

Implications of remuneration on mortgage broker conduct and consumer outcomes

Are mortgage brokers really necessary?

45. ASICs Report 516[14] found:

    " 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."

46. Similarly, the Productivity Commission published findings in PC Report 89[15] that:

    "Brokers can make the home loan market more competitive by increasing consumers' knowledge of loan products and exerting competitive pressure on lenders on behalf of consumers."

47. Zippler submits that major banks are likely to increase market power if there is a reduction in the size and/or accessibility of the mortgage brokers. Without the assistance of mortgage brokers, consumers have demonstrated a significant, disproportionately high and oligopolistic preference for the major banks, which approaches 100%. This is demonstrated by:

    a. The mortgage broking industry is a key distribution channel for residential mortgage financing in Australia, settling 55.7% of all residential home loans in the September quarter 2017[16];

    b. The proportion of loans placed by brokers with the major banks and regional banks owned or aligned with the major banks was 66% in the three months to March 2017[17]; and

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[14] Australian Securities and Investments Commission March 2017 Report 516 p9.

[15] Competition in the Australian Financial System:- Productivity Commission Inquiry Report No.89 p301

[16] Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry :- Background Paper 2: Some Features of the Australian Mortgage Broker Industry p3.

[17] Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry :- Background Paper 2: Some Features of the Australian Mortgage Broker Industry p14.

c. In September 2018 Australian Prudential Regulation Authority (**APRA**) published its Monthly Banking Statistics August 2018 report which states the four major banks, including subsidiaries account for 81.96 of Housing Loans (80.48% of owner-occupied loans; 84.82% of investor housing loans).

48. These statistics suggest that 44.3% of consumers deal directly with lenders for their home loan whereby this minority of consumers exceeds and lifts the major bank share of home loans from the mortgage broker allocation of 66%, to 81.96% overall.

The mortgage broker business model is both complex and unique.

49. Mortgage broker remuneration is a function of consumer loan balances and therefore, both industry and observers struggle to directly relate levels of remuneration with effort expended. This is because, at an individual consumer level, there is no such relationship.

50. However, this approach is well established, industry wide and essentially understood by all participants, including consumers. This relative simplicity, in combination with supply side payment has led to the existence and scale of the mortgage broker sector, that, when conflicts are better managed, play a valuable role broadening market competition and exert downward pressure on home loan pricing, by forcing lenders to compete more strongly with each other for business. Changes to the current remuneration model risk undoing that opportunity.

51. Accordingly, Zippler submits that such changes to mortgage broker remuneration should be approached with caution and should only become a cause for review and potential disruption if conflicts cannot be adequately managed (which they can) or if there is evidence of exceedingly poor value or price gouging by brokers.

52. Notwithstanding the absence of an hourly rate style relationship, as a self-employed professional who often works after hours including nights and weekends, average gross earnings before business costs, interest and tax of $132,406 (comprising $76,827[18] upfront and $56,579[19] trail commission) does not appear excessive.

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[18] Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry :- Background Paper 2: Some Features of the Australian Mortgage Broker Industry p16.

[19] Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry :- Background Paper 2: Some Features of the Australian Mortgage Broker Industry p17.

53. Similarly, publicly listed Mortgage Choice and AFG report modest pretax margins of 12.2%[20] and 7.38%[21] respectively especially when compared to pretax margins for CBA of 47.5%[22] or NAB of 34.08%[23].

54. Further, it is noteworthy that mortgage broking, unlike any other banking or financial service small to medium sized business, performs speculative work which if successful, also carries a particularly protracted cash conversion cycle where:

    a. Effort and resources expended may never realise a return; and

    b. If a return is realised, the minimum cash conversion cycle is likely 72 days, however this can reasonably extend to 180+ days due to the time spent by consumer's finding and purchasing a property which is on average 3.6 months. However, broker engagement will often occur during the research cycle which in itself averages 5.5 months[24].

<u>The role of trail commissions.</u>

55. Like upfront commission, trail commission is a function of consumer loan balances and consequently levels of remuneration bear no direct relationship with effort expended by the broker. Unlike upfront commission, trail commission is calculated on monthly loan balances and paid monthly. This approach causes product strategy conflict, which although it can be mitigated, casts negative view.

56. Despite potentially negative perceptions of trail commissions, the existence of these payment supports a more stable and lower risk sector in that trail commissions:

    a. are only paid if the loan is current and in good health creating a direct financial incentive supporting the Act in ensuring a loan is not unsuitable;

    b. provide significant and important cashflow smoothing for these small to medium business;

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[20] 5 Year Average – Source: https://au.investing.com/equities/mortgage-choice-ratios

[21] 5 Year Average – Source: https://au.investing.com/equities/australian-finance-group-ltd-ratios

[22] 5 Year Average – Source: https://au.investing.com/equities/commonwealth-bank-of-australia-ratios

[23] 5 Year Average – Source: https://au.investing.com/equities/national-australia-bank-limited-ratios

[24] Source: https://www.thinkwithgoogle.com/intl/en-aunz/consumer-insights/innovative-aussie-research-unveils-path-purchase-home-loans/

c. contribute 40-50% of gross revenue received by brokers;

d. help prevent unnecessary churn pressure assisting a more stable lending sector overall; and

e. provide some level of return to the broker for time invested if the lender or consumer triggers a clawback event.

57. It is noteworthy that the most serious, systematic misconduct reviewed and reported upon by the Royal Commission was the NAB introducer scheme which did not pay trail commission.

58. Further, brokers who provide an independent, impartial or unbiased service will, in complying with section 160B of the Act, rebate these commissions to consumers.

<u>The role clawback.</u>

59. When a consumer substantially reduces or pays out a broker originated loan within 2 years (typically), the lender will recover all, or a significant part of upfront commissions paid to the broker. The broker does however, retain trail commissions.

60. This risk has led to some brokers passing that fee on to consumers.

61. Zippler submits this practice by mortgage brokers is unreasonable and should be banned as:

a. Broker levied clawback fees are simply another form of Deferred Early Repayment Penalty which is illegal for lenders;

b. Brokers have a duty to analyse the consumers situation beyond the period a clawback is likely to be charged and therefore, should have factored this event into the consumer strategy prior to recommending a loan; and

c. Clawback may be triggered due to a financial catastrophe affecting the consumer in which case Zippler submits it is unreasonable to further cause the consumer further harm and/or distress particularly in light of duties owed to the consumer by the broker.

<u>For whom does the intermediary act?</u>

What duties does/should a mortgage broker owe to a borrower?

62. A broker of any description by common definition acts as a go-between for two or more parties. However, in the case of mortgage brokers, there is an established sense of confusion surrounding the duties owed to a consumer by a mortgage broker. This is largely due to:

    a. Historic and/or current promotion of mortgage brokers as independent, impartial or unbiased intermediaries by brokers themselves, aggregators, lenders, mortgage broker associations, general media and industry publications and award ceremonies;

    b. The perceived inadequacy of protections of consumers' interests of loan recommendation due to somewhat blinkered focus on the Act's prohibition against suggesting, or assisting with, unsuitable credit contracts in sections 123 and 124 which specifically regarding hardship or risk of hardship causes the suggestion that a loan may not be unsuitable, yet still be highly and unreasonably uncompetitive.

<u>Independent, impartial, unbiased</u>

63. Notwithstanding a quick google confirming continued widespread use of terms such as independent, impartial, unbiased and similar by and to describe mortgage brokers, section 160B of the Act prohibits such use by almost all mortgage brokers wherein:

    160B "Independent", "impartial" or "unbiased" etc.

    (1) A licensee must not, in providing or offering to provide a credit service to a consumer, use any of the following terms (either alone or in combination with other words or letters) in a representation to the consumer about the licensee, the service or the licensee's actions in providing the service:

        (a) the word "independent";

        (b) the word "impartial";

        (c) the word "unbiased"; or

(d) another term (whether or not in English) that is of similar import to a word mentioned in paragraph (a), (b) or (c).

(2) For the purposes of subsection (1), it is a defence if:

(a) the licensee does not receive any of the following:

(i) commissions (apart from commissions that are rebated in full to the licensee's clients); or

(ii) other gifts or benefits from a credit provider or a lessor that may reasonably be expected to influence the licensee; and

(b) in providing a credit service, the licensee operates free from direct or indirect restrictions relating to the credit contracts and consumer leases to which the service relates (except restrictions imposed on the licensee by this Act or by an Australian credit licence); and

(c) in providing a credit service, the licensee operates without any conflicts of interest that might:

(i) arise from the licensee's associations or relationships with credit providers and lessors; and

(ii) reasonably be expected to influence the licensee in providing the service; and

(d) neither of the following persons receives any commission, gift, or benefit, covered by paragraph (a):

(i) the licensee's employer (if any);

(ii) any other person prescribed (whether by reference to a class of person or otherwise) by the regulations.

64. Use of these terms perpetuates consumer misperception that conventional mortgage brokers do not suffer conflicts of interest which may affect the advice and help they receive.

65. The Royal Commission could therefore consider the need to increase monitoring and strict enforcement of section 160B of the Act.

<u>Is "not unsuitable" adequate?</u>

66. While the requirement for a loan to be "not unsuitable" may, in isolation be inadequate to comprehensively protect and progress consumer interests, the general conduct obligations of licensees as set out in section 47 of the Act provide substantive enhancement of duties owe to the consumer stating:

    General conduct obligations

    (1) A licensee must:

    (a) do all things necessary to ensure that the credit activities authorised by the licence are engaged in efficiently, honestly and fairly; and

    (b) have in place adequate arrangements to ensure that clients of the licensee are not disadvantaged by any conflict of interest that may arise wholly or partly in relation to credit activities engaged in by the licensee or its representatives.

67. The interests of the consumer would be protected and advanced if a mortgage brokers act in full compliance with section 47 as:

    a. By complying with section 47(1)(a), the mortgage broker would specifically disclose the lenders they deal with on the consumer's behalf (as opposed to the broker's advertised lender panel which could be significantly more comprehensive) and through this, the consumer becomes aware of the true extent of the broker's options; and

    b. By complying with section 47(1)(b), the broker's arrangements would ensure that all loans matching the consumer's needs and available from lenders the broker deals with are included and that the most cost-effective products and strategies are prioritised for the consumer to ensure they are not disadvantaged through higher interest costs or risk.

68. The Royal Commission could therefore consider the need to increase monitoring and strict enforcement of section 47(1)(a) and section 47(1)(b) of the Act.

Is it desirable to have mortgage brokers act in the best interest of the borrower?

69. Zippler supports the addition of “best interest” as a controlled term under section 160B of the Act.

70. Zippler opposes the inclusion of a best interest obligation as:

    a. the term “best interest” implies heady, comprehensive and universal prioritisation of the consumer’s interest which can lull consumers into a false sense of security thereby heightening risk when the consumer’s perception is mismatched with reality;

    b. a universally interpreted and appropriate measure of compliance is unachievable so interpretation will therefore, always be subjective and, except in the most extreme cases (where the loan is likely to be deemed unsuitable) difficult to enforce. For example, under what circumstances is an LVR of 80% in the best interest of the consumer; how can that be monitored; how can that be enforced?;

    c. monitoring and enforcement will be resource intensive and difficult; and

    d. adequately monitored and enforced, sections 47(1)(a) and (b) of the Act can ostensibly deliver the same level of consumer interest protection without further compounding misperception risk and associated consumer harms.