Combined Industry Forum response to the Royal Commission Interim Report.

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1. Royal Commission Interim Report and the Combined Industry Forum

The Combined industry Forum (CIF) welcomes the opportunity to provide further clarity on its package of reforms developed in November 2017 in response to ASIC Report 516: Review of Mortgage Broker Remuneration (ASIC Report), and to respond to issues raised in the Interim Report.[1]

1.1 The work of the CIF

We note the Commission's comments in respect to the operations of the CIF[2]. The CIF was established in June 2017 to address perceived or potential risks raised in the ASIC Report and Retail Banking Remuneration Review (Sedgwick Review), with terms of reference (refer Appendix 1) setting the scope of the CIF's work to:

> *"…develop industry-based responses to the ASIC proposals[3], and have regard to the third-party recommendations of the Sedgwick Review[4]. These industry-based responses will be presented to the Government and ASIC to help inform the Government's response to the ASIC proposals."* [5]

This scope confined the work of the CIF to addressing the six proposals of the ASIC Report and their intersection with the relevant recommendations of the Sedgwick Review. In particular, and consistent with some of the themes identified in the Interim Report, the CIF has focused on the potential conflicts identified in the ASIC Report[6], namely the:

- **Product strategy conflict** – "A broker could recommend a loan that is larger than the consumer needs or can afford to maximise their commission payment. This may also involve recommending a particular product or strategy to maximise the amount that the consumer can borrow (e.g. through the choice of an interest-only loan)."
- **Lender choice conflict** – "A broker could be incentivised to recommend a loan from a particular lender because the broker will receive a higher commission, even though that loan may not be the best loan for the consumer."

This approach has enabled the CIF to lead and progress meaningful industry reform that aims to address issues identified in the ASIC Report and the relevant recommendations of the Sedgwick Review that pose the greatest risk to good customer outcomes in mortgage broking. While current indicators, arrears rates and the low incidence of customer complaints do not suggest significant issues, the CIF recognises that the industry can do more to increase reporting, governance and oversight across the industry.

The terms of reference also require the CIF to take into account the contribution of mortgage broking to competition and consumer choice in the home lending market and the unintended consequences associated with changes in the industry.

The CIF voted on 10 October 2018 to expand its terms of reference to allow it to respond to other inquiries and reviews. This is a significant step and allows the CIF to consider a broader range of issues and to respond to regulators, government and the Royal Commission alike. With these expanded terms of reference, the CIF will re-examine all potential options identified around remuneration models specifically to better address potential conflicts, reinforce the expectations for brokers to deliver good customer outcomes and address risks as they arise. This will be done

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[1] Interim Report of the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry.
[2] Interim Report of the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry. P62
[3] ASIC Report 516, 'Review of mortgage broker remuneration', pp.23-27.
[4] Recommendations 16, 17, 18(a), 20(a), 21 of the *Final report of the Retail Banking Remuneration Review*.
[5] Improving Customer Outcomes, The Combined Industry Forum response to ASIC Report 516: Review of mortgage broker remuneration. p27
[6] ASIC Report 516, 'Review of mortgage broker remuneration', p 10 para 29

with an approach that promotes competition and maintains the focus on good customer outcomes.

The CIF's response addresses several areas:

- Changes to remuneration structures, focussing on managing lender choice and product strategy conflicts to address the risk of poor consumer outcomes as noted by ASIC.
- A measure for good customer outcomes.
- Improved disclosure (customer tested) and public reporting.
- Governance framework and measurement of outcomes.
- An enforceable mortgage broking industry code.

Subsequently, the CIF added a 'customer first duty' to the above.

The CIF maintains that these measures when viewed collectively provide an integrated approach to continuously improving customer outcomes, standards of conduct and culture, while preserving the mortgage broking industry and the competition, broader economic benefits and customer choice benefits that it delivers. Considering the proposed reforms individually risks overlooking the interoperability and true benefit of the CIF led reforms which work together to better manage the risk of poor customer outcomes from product strategy and lender conflicts.

1.2 Consumer engagement

CHOICE, representing multiple consumer groups, has been an active participant in the CIF as an independent consumer advocate. Consumer groups largely welcomed the original reform package proposed by the CIF in November 2017 but have strongly advocated for further industry change, notably around trail commissions and implementing a best interest duty for mortgage brokers.

1.3 Competition law

The operations of the CIF are subject to competition law. 'Participants must not disclose their own current or proposed prices or pricing methods, remuneration structures, any commission, incentive or other payment paid to employees or third parties, business plans or any other aspects of commercial strategy, except where and to the limited extent necessary for the purpose'.[7]

Further, it is up to members to make an individual decision as to whether to implement the reforms.

1.4 The role of mortgage brokers in competition and customer choice

Mortgage brokers are acknowledged to contribute to competition in the home lending industry.

The importance of both competition and customer choice was noted by Treasury who stated *"As a key distribution channel for mortgages, and by assisting consumers' search for a better deal, mortgage broking also has a vital role in facilitating effective competition and better outcomes for consumers that needs to be taken into account in assessing reform options"*[8]. Any consideration of policy recommendations that may be made in the final report of the Commission should reflect how the competition driven by mortgage broking has previously, and continues to benefit customers.

Brokers play a critical role for all lenders, and in particular smaller lenders that do not operate extensive (or any) branch networks. To this point the Productivity Commission noted:

> *Based on analysis of ASIC data, we estimate that, by distributing loans through brokers, smaller lenders have on average increased their market shares by 1.55 percentage*

[7] Combined Industry Forum Competition protocol, prepared by Gilbert and Tobin.
[8] Financial Services Royal Commission, The Treasury – submission on key policy issues, background paper 24, P40, Para 161

points. If mortgage brokers were not available, these lenders would need to have an additional 118 branches each on average in order to maintain their current shares in the home loan market. Mortgage brokers are thus integral to smaller lenders' ability to compete.[9]

The impact of any proposals that may lead to contraction or significant structural change to mortgage broking would need to be carefully considered to ensure continued competition in the sector, and by extension, to ensure customers continue to have choice when seeking residential home loans.

2. CIF response to questions

The CIF is responding to a number of issues raised in the Interim Report,[10] and has responded to the questions with three areas of focus: remuneration; governance and risk management; and culture and conduct. The questions that particular sections address are contained as follows.

Royal Commission Interim Report Questions	Combined Industry Forum Response	Section No.
What duties should an intermediary owe to a borrower?	The CIF has noted the questions raised in the first hearing in relation to who does the broker work for and, who does the customer think the broker works for. To address this issue, the CIF intends to make it clear to the customer that the broker acts in their interests first. To enable this, the CIF is adopting a customer first duty. The answer is the broker works for the borrower, but performs tasks for both the customer and the lender throughout the process of obtaining a loan for the borrower. The CIF proposes a customer first duty, that requires a broker to place the borrower's interests ahead of their own. Further, the good customer outcomes measure determines specific requirements that the broker is expected to meet.	2.1, 5.1
How can entities' systems be improved to detect and prevent breaches of responsible lending obligations by intermediaries?	The CIF is developing a comprehensive governance framework that is supported by a range of Key Risk Indicators (KRIs) (and supported by customer outcomes surveying) aimed at identifying trends in broker behaviour that may lead to poor customer outcomes. This is intended to be further supported by an industry code that is under development that will have monitoring and supervision and an enforcement regime incorporated.	4.1 & 5.2
What should be disclosed to borrowers about an intermediary's remuneration?	In addition to existing requirements of the National Consumer Credit Protection Act (2009) (NCCP Act) providing for disclosure of commission and fees, the CIF has proposed a number of other disclosures to add further transparency.	3.2.1

[9] Competition in the Australian Financial System – inquiry report pp 312-313
[10] Interim Report of the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry. P325

Is it desirable to prescribe that some or all of those who are not employees of lenders, but deal with bank customers, must act in the interests, or the best interests, of the client?	The CIF proposes a customer first duty that requires a broker to place the borrower's interests ahead of their own. Further, the good customer outcomes measure determines specific requirements that the broker is expected to meet. The combination of these is outcome-based rather than process-based, and aim to identify and address poor behaviour.	5.1
In particular, what duty, if any, should a mortgage broker owe to the prospective borrower?	In addition to the good customer outcomes identified by the CIF, the CIF considers that brokers should have an obligation to place borrower's interests ahead of their own, directly addressing the product strategy and lender choice conflicts as identified in the ASIC Review.	3.2
How is a value-based commission consistent with acting in the interests, or best interests, of the client?	Members of the CIF have independently ceased volume-based bonus commissions, campaign-based commissions and volume-based bonus payments. Further, the proposed principle that broker payments are to be made based on what is drawn down and used by the customer (generally facility limit net of offset) will remove the financial incentive for a broker to recommend a larger loan.	3

2.1 Who does a mortgage broker act for?

The NCCP Act sets out the steps the broker must take when providing credit assistance, but not who they owe their obligations to.

It is not necessary to reframe the law to address this point, as noted in the CIF progress report, the CIF has been working for some time on a customer first duty[11]. The report notes "*the combination of the good customer outcome definition and a customer first duty allows both an easy to follow principle – put the customer's interests first – and structure to follow for brokers when assessing loan suitability.*"

The CIF is integrating a customer first duty into the Governance Framework and the Mortgage Broking Industry Code to make it clear to the customer that the broker acts in their interests first.

3. Changes to remuneration[12]

The CIF is responding to a need to lift standards as highlighted by ASIC in relation to remuneration practices in mortgage broking relating to:

- The potential for financial incentives to put good customer outcomes at risk where they encourage customers to borrow more than they need.
- The potential for volume-based bonus commissions, campaign-based commissions and volume-based bonus payments paid by lenders and aggregators to brokers or by lenders to aggregators to put good customer outcomes at risk.
- Certain soft dollar benefits that can increase the risk of poor customer outcomes and can undermine competition.

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[11] Combined Industry Forum Progress Report: Working towards a better mortgage broking industry for customers, P18

[12] The section addresses concerns raised in the Interim Report of the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry. P59-63, 6.1.2 Remuneration

To respond to these risks and balancing competition and customer choice, the CIF has facilitated the following proposals to minimise the risks in the remuneration structure for residential mortgage lending:

- Changing the standard commission model – To the extent that remuneration relates to loan size, remuneration should relate only to the funds drawn down and utilised by a customer – Due end 2018. A number of lenders have individually implemented this principle, generally by calculating the commission based on funds drawn down, net of offset. We consider this principle, if adopted broadly, would have the potential to make a substantial difference to the product strategy conflict risk.
- Moving away from volume-based bonus commissions, campaign-based commissions and volume-based bonus payments –The CIF recognises ASIC's expectation that the industry moves away from these commission and payment structures. Following individual assessments and decisions in relation to these commission payments, industry participants have already ceased these payments, which has resulted in a removal of a considerable product strategy conflict risk. Importantly campaign and volume bonus incentive schemes that were in place before the CIF response have also been ceased, meaning no new payments will be made under these schemes. The industry has not 'grandfathered' any of these schemes, and we understand there is no intention to introduce any new ones.
- Moving away from soft dollar benefits – The CIF further recognises ASIC's expectation that the industry moves away from soft dollar benefits and has proposed changes to Tiered Servicing (Broker Clubs), Conferences/Professional development events and Entertainment and Hospitality – Due end 2018. Collectively, these reforms go straight to the heart of broker conduct and culture and ensure that brokers' education is focussed and geared towards better outcomes for the customer.

These changes directly address proposals 1-3 of the ASIC Report[13] and recommendations 16 and 17 of the Sedgwick Review, and contribute to addressing both the product strategy and lender choice conflicts as outlined above[14].

3.1 Difficulties and unintended consequences of alternative models

The CIF acknowledges the observations and criticisms of some stakeholders of value-based remuneration in mortgage broking.

The CIF reforms also recognise that the industry has not identified an alternative remuneration model which would be free of the types of conflicts criticised in the standard commission model and would not have potential detrimental and unintended consequences. As noted above, following the recent change to the terms of reference, the CIF will re-examine all potential options identified around remuneration models specifically to address potential conflicts. This will be done with an approach that promotes competition and maintains the focus on good customer outcomes.

Nevertheless, in arriving at the remuneration reforms outlined above, the CIF response to ASIC contained reference to a rigorous assessment of alternative remuneration[15] undertaken by the Mortgage and Finance Association of Australia (MFAA). This assessment is set out in Appendix 2 and is provided to assist the Commission to identify the complexities and unintended impacts for customers (including first home buyers) of each alternative. These considerations will also form the basis on which future investigations into remuneration models will be taken forward.

The main categories and their potential unintended consequences are discussed below.

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[13] ASIC Report 516, 'Review of mortgage broker remuneration', Para 112 page 23 (a) to (c)
[14] Note reference to questions outlined in the Interim Report of the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry., P325 S 7.4 Intermediaries - value based remuneration
[15] MFAA submission to ASIC 516 review of mortgage broker remuneration Pp26-44

3.1.1 Customer paid fee for service (in lieu of commissions)

While customer paid fee for service may reduce lender choice and product strategy conflicts, there are a range of likely impacts:

- Rationalisation of broker numbers, reducing competition and customer choice.
- Increase of barriers to entry for new lenders, whilst disadvantaging smaller lenders and those without a branch footprint, including new to market competitors such as fintechs.
- Result in additional direct costs to customers to access the broker channel, diminishing the broker value proposition to the customer, especially to first home buyers and those on lower incomes.
- Put brokers at a significant disadvantage to the lender branch channel (who do not generally charge direct fees).

A customer paid model is unlikely to correlate to economic value produced by the broker.

It may also introduce a range of other conflicts that could potentially result in brokers structuring advice and services to maximise fees. In addition to having the same sort of incentives as the current standard commission model, namely an incentive to suggest product structures to maximise fees, a customer paid fee will introduce other perverse incentives such as:

- a disincentive to take on customers with complex requirements and objectives requiring more time; and
- an incentive to shift customers from product to product or lender to lender.

The Productivity Commission also recognised 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."*

3.1.2 Standardisation of upfront commission percentage

While standard upfront commission percentage may reduce lender choice conflict, by itself, it would not reduce product strategy conflict. Further, this method does not differentiate between complex products and may infringe competition law if implemented by industry agreement.

3.1.3 Base commissions paid on Loan Value Ratio (LVR)

Such an approach may provide a financial incentive to exclude high LVR lending, for example to first time home owners and could encourage the greater use of guarantees from related parties (such as elderly parents) to reduce LVRs.

3.1.4 Flat lender fee

A flat lender fee could provide a financial incentive for brokers servicing a narrow band of customers, for example, those with simple lending needs. However:

- It may not reduce product strategy conflict in the case of tiered fees.
- It has no correlation to economic value produced.
- It could negatively impact pricing on smaller loans, and
- It may result in split loans for customers.

Further the Productivity Commission report noted that:

> *"A ban on commission based- payments in favour of fees would not eliminate the conflicts of interest that brokers face. While such a ban may address the product*

strategy- conflicts (that is, the incentive to prefer larger loans), it would not address lender choice- conflict (the incentive to prefer lenders that offer higher payments).”[16].

3.1.5 Effect of CIF changes

The proposed changes outlined by the CIF[17] to pay commissions based on the funds being drawn down and utilised by the customer (net of offset) directly addresses the biggest risk to customers arising from product strategy conflict.

This change means that mortgage brokers will no longer be paid on facility limits or have a financial incentive to recommend larger loans that initially have large offset balances. The CIF has proposed this reform to enhance the requirement for a loan to meet the customer’s requirements and objectives, specifically in relation to loan size and loan purpose, and promote good customer outcomes. When coupled with the governance framework proposed, this is a significant step forward.

Nevertheless, with the change in the terms of reference the CIF will re-examine all potential options identified around remuneration practices pursuant to the questions posed by the Royal Commission over the coming period.

3.2 Clearer disclosure

3.2.1 What should be disclosed to borrowers about an intermediary’s remuneration?

Mortgage brokers are required by the NCCP Act to disclose the remuneration received from the lenders on their panel at various points.

It is disclosed initially in the Credit Guide, which must be given to the customer as soon as practicable, after it is likely that the mortgage broker will provide credit assistance. The Credit Guide must contain information about any remuneration likely to be received by the mortgage broker as a result of providing such credit assistance and whether the remuneration is paid by the lender, aggregator, customer or some other party to the transaction.

A more detailed commission disclosure is then contained within the Credit Proposal that is given to the client at the same time the broker provides credit assistance[18].

In broad terms, disclosure requirements for the Credit Proposal document entails providing detail (in dollars) of fees, upfront commission and trail commission and explanations of each including by whom and to whom each is made[19].

The CIF has proposed further changes to incorporate other disclosures to borrowers in relation to a number of other areas that the CIF considers the borrower should be aware of. CIF considers that in addition to the other reforms, the proposed disclosure will assist a customer’s understanding of potential conflicts, increase transparency and reduce, or acknowledge the existence of, potential conflicts. The proposed disclosure is as follows:

- Significant ownership:
  - Disclosure of ownership structures would be required where ownership is 20% or greater, or, where ownership is less than 20%, a board seat is held, or a white label product is offered by a substantial shareholder (as defined).
- Lender Coverage:
  - A list of lenders available to a customer via a broker’s aggregator.
  - Which lenders a broker has used in the previous financial year.

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[16] Productivity Commission report competition in the Australian Financial system P 322
[17] Improving Customer Outcomes, The Combined Industry Forum response to ASIC Report 516: Review of mortgage broker remuneration. P11
[18] S121 NCCP Act
[19] Chap 3 NCCP Regulations

- The top six lenders used by a broker and percentage of business written with each in the previous financial year. This will indicate to a customer if the broker is continually favouring one lender over others that are available to them.

3.2.2 Approach to disclosure of ownership

The proposed approach to disclosure of ownership plays an important part in addressing community concerns in relation to potential conflicts of interest, and specifically the lender choice conflict. It is intended that the following will be disclosed to the customer:

- Disclosure of significant ownership (as noted above);
- Membership of a tiered servicing model;
- Number of lenders available to a broker;
- Number of lenders used in the previous financial year; and
- Top six lenders used, and percentage of business concluded with each in the previous financial year.

To ensure these are meeting expectations, the disclosures will be subject to customer testing.

To create transparency and ensure customers are informed when making decisions, participants in the industry will more clearly disclose their ownership structures and other circumstances in which they may have the ability to exert influence. The guidelines for doing so have been drafted and will be subject to customer testing. These proposals address reforms 4 and 5 of the ASIC Report.

The industry has already made the first step in adopting the proposed reforms outlined above. The introduction of the improved governance and reporting framework and the implementation of the codified customer first duty are designed to work hand in hand with the changes in remuneration to help ensure good customer outcomes.

4. Governance and risk management

The CIF notes and agrees with the Commission's statement noting "*Good culture and proper governance cannot be implemented by passing a law. Culture and governance are affected by rules, systems and practices but in the end they depend upon people applying the right standards and doing their jobs properly.*"[20]

The centrepiece of the CIF reform package is a comprehensive governance framework for the mortgage broking industry. The framework is intended to detect, manage and, ultimately, enforce good customer outcomes. The 'customer first duty' (which is further described in section 5.1 of this document) is intended to work in concert with the framework and be incorporated throughout the operations, requirements and measurements.

4.1 Components of the governance framework

A number of parts make up the governance framework, which are intended to work in unison to deliver good customer outcomes:

- **Reporting** – The reporting will provide visibility of broker behaviour and ensure that parties can effectively monitor behaviour, with a view to remediation and enforcement (see below).
- **Portable unique identifiers** – The CIF is working with ASIC on the potential development of a portable unique identifier. It its envisaged that the identifiers will stay with individuals regardless of where they operate in the industry. The establishment of portable unique identifiers will make it easier to identify individuals

[20] Interim Report of the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry. P320-321

who have a history of poor behaviour across multiple employers. Those exhibiting poor behaviours may be sanctioned or potentially removed from the industry.

- **KRIs** – Key risk indicators operate to act as 'red flags' of potential poor broker behaviour and aim to identify patterns where broker conflicts may arise providing direction to governance effort and ensuring adequate resources are made available to address any issues identified.
- **Customer feedback** - The development of an industry survey to measure customer feedback on the customer outcome which will form a key part of the monitoring process.
- **Enforcement**– it is envisaged that in circumstances where brokers' standards have resulted (or may result) in poor customer outcomes, the brokers may receive training, be sanctioned or potentially removed from the industry. It should be noted that industry bodies already have disciplinary rules and procedures in place to address poor broker behaviour.

The CIF believes that improvements to the governance of mortgage broking and clearly explaining and strengthening conduct obligations within the industry, will be one of the greatest drivers for improvements in customer outcomes from the mortgage broking channel.

Changes to governance, oversight and reporting will mean that data in relation to poor behaviour or poor customer outcomes is collected, analysed and used to identify and address potential systemic issues from the mortgage broker channel. These changes will inform continuous improvement activity across mortgage broking, and will also assist response times for ASIC reviews and oversight.

In practice this means a governance framework that would be:

- **Self-assessing** – Industry reporting and KRIs that identify trends in broker behaviour will be reported to regulators and taken account of by lenders and aggregators when assessing respective compliance.
- **Self-correcting** - The CIF is considering a range of data driven monitoring procedures that will encourage industry participants to meet community standards and expectations (including the good customer outcomes measure). Further, this is reflected in the development of the customer first duty, the Mortgage Broking Industry Code (that is currently under development) and the consideration of potential remediation steps (such as training, sanctions and potentially, removal from the industry).
- **Continuously improving** – The CIF is considering data gathering remediation and reporting processes that will allow ongoing review of remuneration structures and that will become more sophisticated over time. The CIF members have noted that they must remain diligent and monitor behaviour on an ongoing basis. The CIF also considers that good customer outcomes and the customer first duty as implemented through the industry code (which is addressed in section 5.2) will become the key drivers of compliant conduct and ensure that the community standards and expectations continue to be maintained.

4.2 A holistic view of reform

Partly as a function of the CIF's reforms being divided into six separate areas of focus, the intended overall outcome can be obscured. However, the CIF urges the Commission to consider the reforms in a holistic manner, as the proposed CIF reforms are intended to work together to increase their relative impact. Collectively, the reforms are building a governance framework that will continue to improve customer outcomes and standards of conduct and culture whilst preserving competition and customer choice.

Underpinning the governance framework is a Mortgage Broking Industry Code and the customer first duty, which will be covered in more detail below. The table attached at Appendix 3 outlines the CIF proposed reforms from the 2017 response to ASIC.

5. Culture and conduct (including enforcement)

Noting the commentary in the Royal Commission Interim Report that states:

> *"It is not immediately clear what would be the content of a 'customer first' duty. In particular, it is not clear how this form of duty is intended to differ from the duty to act in the best interests of the client that the Corporations Act imposes on financial advisers. Nor is it clear, if the two forms of duty are to be given different content, why the duty a mortgage broker owes to a borrower should differ from the duty a financial adviser owes a retail client."*[21]

5.1 The customer first duty and good customer outcomes

The Customer First 'Duty' is principle-based and works with the Good Customer Outcomes measure to drive positive behaviour in the mortgage broking industry.

The intent of a principles based duty, that emphasises putting the customer first is to set a simple and unambiguous expectation for the broker and addresses the Commission's observation - *"The more complicated the law, the easier it is for compliance to be seen as asking 'Can I do this?' and answering that question by ticking boxes instead of asking 'Should I do this?"*[22]

As the Commission has noted, failure to appropriately manage conflicts of interest has put good customer outcomes at risk, and driven examples of misconduct and conduct falling below community standards and expectations. The CIF agrees with the Commission that a higher duty should be imposed.

The CIF supports in principle a new obligation that addresses the conflicts faced by brokers. The customer first duty is intended to operate in a similar form to the obligations outlined in s961J of the Corporations Act 2001 which states that "the provider must give priority to the client's interests when giving the advice".

It is intended that the customer first duty will be implemented through the Mortgage Broking Industry Code and the governance framework more broadly. The CIF is currently working through the implementation and notes previous comments made in the progress report that "development and application of a customer duty is multifaceted and complex, and there may be unknown impacts[23]." Central to the implementation will be principles that the duty is:

- Fit for purpose and tailored to the mortgage broking industry;
- Simple and understandable for a consumer; and
- Practical, implementable and outcomes based.

Working in unison with the customer first duty, the good customer outcomes measure provides benchmarks for measurement that are built into reporting and the governance framework as they are being developed. Combined, they read as follows:

> *"I place your interests first in my dealings with you [speaks to the customer first duty]. In doing so, I will ensure I recommend a loan which is appropriate (in terms of size and structure), is affordable, applied for in a compliant manner and meets your set of objectives at the time of seeking the loan [speaks to the Good Customer Outcome measure]."*

The key features of the duty and good customer outcomes measure will assist in setting a higher standard than existing regulation ('not unsuitable' as outlined in the NCCP Act) and directs the broker to place the customer's interests ahead of itself. It also:

- clearly orients the actions of brokers to the customer[24]; and
- is principle-based, and focusses on the outcome, rather than the process[25].

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[21] Interim Report of the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry. P62
[22] Interim Report of the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry. P290
[23] Combined Industry Forum Progress Report July 2018, P18
[24] Aligns to concerns raised in Interim Report of the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry., P56 S 6.1.1

The CIF considers the good customer outcomes principle, if adopted, will hold the industry to a higher standard than those already existing in the responsible lending requirements outlined in the NCCP Act.

The principle states, *"The customer has obtained a loan which is appropriate (in terms of size and structure), is affordable, applied for in a compliant manner and meets the customer's set of objectives at the time of seeking the loan"* and can be broken down into the following measures:

- Appropriate size and structure of the loan;
- Meeting the customer's stated requirements and objectives;
- Affordability for the customer; and
- Applied for in a compliant manner (meeting all responsible lending requirements).

As noted, the above measures form a pillar of the reporting and governance framework. Further, they form the basis of a test to determine if the desired customer outcome has been met.

The CIF has also developed 6 KRIs to support the reporting for the governance framework:

- % of portfolio in Interest Only, as an example of a product and whether for investment or owner occupier purposes;
- Arrears (90+ days or average weighted arrears in the first 12 months);
- "Switching" in the first 12 months of settlement;
- Elevated level of customer complaints;
- Poor post settlement customer survey results of the broker experience; and
- The quality of the loan, identified through any deficiencies found in Requirements and Objectives (R&O) documentation.

The first four of these are specifically targeted at monitoring the behaviour of the broker, by identifying patterns that identify or may predict poor customer outcomes. The last two, are aimed at identifying deficiencies in broker behaviour that have happened with a view to remedial action. It is noted that many members will be operating a broader range of measures. Ultimately, depending on the measure's outcome, the broker could be removed from the industry.

These specific KRIs, in support of the customer first duty, are intended to be enforceable through a new compulsory Mortgage Broking Industry Code.

5.2 Mortgage Broking Industry Code

The Mortgage Broking Industry Code is intended to be focussed on outcomes rather than process. The CIF's goal is to work towards an ASIC approved code for all participants in the mortgage industry. However, as this process will take some time, as an interim step, the CIF is looking to enforce the code through the existing industry association compliance structures.

Should an ASIC approved code not be achievable, and an industry-based code viewed as inadequate, a regulatory approach will be considered. The important aspect of the code is that it enshrines the reform measures recommended by the CIF, and influences behaviour to improve customer outcomes, rather than providing a process for how it is delivered.

Importantly, the Mortgage Broking Industry Code will contain, amongst other things, the customer first duty with the intention that the customer first duty will be incorporated into the commercial relationship between mortgage brokers and their customers in a way which gives rise to a contractual obligation that is enforceable by the customer[26], through the Australian Financial Complaints Authority (AFCA) as an industry code.

The CIF is working to implement an industry-based code in 2019 to ensure that a robust supervision and monitoring system (which will receive data from the public reporting mentioned

[25] Addresses concerns raised in Interim Report of the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry. p140
[26] Addresses Interim Report of the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry. P71

above) is in place and this will be supported by an enforcement regime that includes robust remediation measures.

6. Concluding remarks

The CIF reforms that have been adopted and implemented or are underway are substantial and targeted at the conflicts noted in the ASIC Report, Sedgwick Review, Productivity Commission Report, Royal Commission Interim Report and other sources. In developing its response, the CIF notes:

- The strong contribution the mortgage broking industry makes to competition, and
- Customers continue to show a preference for using brokers.

This comes with the acknowledgement that as an industry we need to maintain and build trust with the community. The work of the CIF will continue to evolve to respond to the outcomes of the Royal Commission and meet community expectations.

Changes to governance, oversight and reporting will mean that poor behaviour and/or poor customer outcomes will be more readily identified and addressed and feed into a cycle of continuous improvement in mortgage broking.

Noting the Royal Commission’s concerns, the CIF is facilitating the remuneration reforms noted in reforms 1-4, changes to governance and risk noted in reforms 5 and 6, the development of the Mortgage Broking Industry Code, and finally the development of the customer first duty and the good customer outcomes measure. Collectively, these changes will address both culture and conduct, while maintaining the contribution to the economy and sustaining competition, customer choice and access to credit services that mortgage broking brings to residential home lending market.

The CIF maintains that improvements to the governance of mortgage broking, strengthening conduct obligations through industry led reform, and the introduction of the customer first duty will be one of the greatest drivers for improvements in customer outcomes.

7. Appendices

7.1 Appendix 1. Combined Industry Forum terms of reference (updated 10/10/18)

Objective

1) The Combined Industry Forum's (CIF) objective is to work with Government, ASIC and consumer representatives to develop a co-regulatory solution to design and implement changes to remuneration and governance practices in the mortgage industry.

Guiding principles

2) In responding to proposed changes to remuneration and governance practices in the mortgage industry, the CIF, including industry associations, brokers, aggregators and lenders will:

1. Support a co-regulatory approach and, to the extent possible, support industry self-regulation.
2. Have better consumer outcomes at the centre of its approach.
3. Ensure appropriate transparency of process for industry participants, government and consumers.
4. Promote competition at all levels of the industry.
5. Not aim to change the structure of the industry or unfairly disadvantage any part of the value chain.
6. Promote simple and achievable solutions, and
7. Seek solutions that can be applied in all jurisdictions and that take account of the needs of metropolitan, regional and country areas.

Scope

3) *The CIF will develop industry-based responses to the ASIC proposals, and ~~have regard to the third-party recommendations of the Sedgwick Review~~ have regard to recommendations of the retail banking remuneration review (Sedgwick Review) and other key inquiries where agreed through the CIF. These industry-based responses will be presented to the Government, ASIC and other agencies as agreed through CIF.*

4) The response will be developed in accordance with the Work Plan, approved by the Forum.

Timing

5) The Forum will provide regular updates to ASIC and Treasury, and a formal interim response outlining progress to the Government by Monday 13 November 2017.

Consultation

6) The Forum will consult and engage regularly with Government, ASIC and consumer representatives.

Resources

7) The CIF will be supported by a Secretariat within the associations, technical resources provided by CIF participants, and by external legal and technical resources as approved by the CIF.

7.2 Appendix 2. Possible solutions to ASIC broker remuneration recommendations

#	Name	Description	Advantages	Disadvantages	Does it discourage larger loans?	Overall/Other comment
Recommendation 1: Improving the standard commission model						
1.1	**Pay upfront on drawn amount net of offset (No upfront top up)**	Pay upfront on drawn amount net of offset with no payment ever made for amount in offset account	Reduces the potential for behaviour that may encourage larger loan sizes to be placed in offset	Unintended consequence could be to not pay commission on funds placed in offset for a renovation or deposit on investment property or any other legitimate imminent use	Yes, but unintended consequences	Does not compensate brokers for legitimate additional drawings
				Could impact construction loans which would need to be excluded		
				This is a measure that only addresses the use of offset and not the full population of loans		
				Would need checks and balances to ensure that brokers do not delay deposit into offset in order to maximise upfront.		

1.2	**Pay upfront on drawn amount net of offset (with subsequent upfront top up)**	Pay commission on drawn amount less offset balance. In 6 to 12 months (to be decided) pay top up upfront commission based on offset balance at the time of top up but only if the offset balance for materiality purposes is less than a certain percentage (say 90%) of what it was immediately after the loan was drawn. If the offset balance is greater than 90% of what it was at the time the loan was drawn then no top-up is payable. This 10% buffer is to put in a materiality test and to remove any normal fluctuations that one would expect to occur in an offset balance	Reduces the potential for behaviour that may encourage larger loan sizes to be placed in offset	More complex in requiring two upfront payment calculations and two disbursements by Lenders	Yes, but possibly less so than option 1.1	Most suitable of variations 1.1, 1.2 and 1.3 despite the need to pay twice
		In order to avoid abuse of the top-up this measure will likely require a timing window that lenders can use to assess the top-up payment so that it is not scheduled to occur on a particular day	Reduces unintended consequences associated with 1.1	This is a measure that only addresses the use of offset and not the full population of loans		
			The drawing of additional funds and placing in offset can be a very strong solution for a customer and this solution allows that to happen but with delayed payment provided that a minimum amount (say 10%	Always a risk of fragmentation of approach if lenders adopt different solutions here		

			of the amount) is used within a stipulated period			
				Creates an uncertainty for broker's revenue		
				Would need checks and balances to ensure that brokers do not delay deposit into offset in order to maximise upfront		
1.3	**Pay upfront on drawn amount (with clawback for non-utilisation)**	Pay upfront on drawn amount and then clawback upfront to the extent offset is not utilised within a period such as 6 or 12 months	Reduces the potential for behaviour that may encourage larger loan sizes to be placed in offset - but possibly less so that measures 1.1 and 1.2	More complex to administer as requires a clawback in 6 to 12 months	Will have some impact but less so than options 1.1 and 1.2 above	More complex to administer and doesn't immediately reduce broker compensation that may be causing the behaviour. Complexity adds opportunity for dispute
				Clawback is a source of conflict between Lenders, Aggregators and Brokers which we are reluctant to add to		
				Does not have immediate effect on brokers compensation where it may be causing the behaviour		
				This is a measure that only addresses the use of offset and not the full population of loans		
				Creates an uncertainty for broker's revenue		

1.4	**Broker to disclose the incremental total cost of the additional offset funds over the term of the loan.**	Where a broker has recommended that a customer add funds to the loan size to be placed in offset the broker to tally loan repayments over term including offset then to deduct sum of loan repayments excluding offset with the net balance to be disclosed to the customer as the potential maximum additional costs (principal and interest) of repaying the additional funds over the life of the loan should they be drawn	Will highlight the true impact of the additional funds over the life of the loan	Requires additional effort by broker	Yes	Needs further discussion as to how easily this can be achieved in a manner that ensures accurate disclosure
		This in essence highlights the incremental repayments related to the offset amount on the assumption it is drawn day 1	The drawing of additional funds and placing in offset can be a very strong outcome for a customer and this solution allows that to happen provided appropriate disclosure occurs to the customer of the impact thereof	Could be cumbersome and could confuse clients given that existing disclosures on pre-disclosure statement/contract already disclose the total repayment amount on the loan over its life		
				Risks a lack of standardisation across the industry in terms of disclosure		
				Not population wide		
1.5	**No upfront commission paid on cash-out**	In circumstances where there is a refinance there is no upfront commission paid on cash out	Will reduce behaviour that encourages larger loan sizes to be placed in offset	Could impact someone wanting to take equity out of home for use as a deposit for investment property with another lender or to pay off higher priced debt for	Yes	Too many unintended consequences reduces choice

				example		
				May encourage brokers to use a single lender with cross collateralisation to avoid cash out which may in effect limit customer choice and not be a good consumer outcome		
				Could result in broker not being compensated for legitimate loan		
				Could restrict customer flexibility in terms of how they use their funds forcing them to go direct to the bank and cutting out the broker which would unfairly disadvantage the broker and aggregator		
1.6	**Pay upfront for legitimate investment purposes only**	Only pay upfront on home loans and “genuine” investment purposes such as - residential and investment home purchases, home renovation, debt consolidation, financial planning investment e.g. super, any other legitimate investment	Will discourage broker driven increases in loan size for non-investment or general liquidity purposes	Restricts customer choice on what they may use their equity for when using a broker and could force them to go to a lender directly which would unfairly disadvantage the broker and aggregator	Partially	Too complex and complexity adds opportunity for dispute
				Could be complex to administer - will need to define inclusions and exclusions		

1.7	**Pay upfront on loan size & LVR (Pivot)**	Pay lower commission % for higher LVR and higher commission for lower LVR around an agreed pivot point e.g. 80%	Discourages brokers from writing higher LVR loans which in turn discourages higher loan size	Results in an inverse relationship between reward and effort (brokers advise higher LVR tend to involve greater effort)	Yes	One aggregator found they earned more when a Lender introduced this type of structure - 1.5 to 2.5 basis points more for a period
		Example: 95% = .0053 90% = .0057 85% = .0061 **80% = .0065 Pivot** 75% = .0069 70% = .0073 65% = .0077	Aligns to prudential objectives and references in both the ASIC Rem Report and Sedgwick report to LVR. Regulator would argue lower LVRs are a good consumer outcome	Many high LVR loans are not poor outcomes. Often loans for medical professionals are high LVR and very complex in terms of personal financial structure or trusts requiring significant additional work which would not be compensated for in this instance. The LMI work above 80% in itself complicates and adds to workload which again is not compensated for		There are already measures going this way (such as risk-based lender pricing) so brokers are likely to be writing less high LVR loans in future in any event so potentially attacking this twice
			Correlates to risk weighted capital - higher risk/lower cost to originate	Ignores valid use of tax driven high LVRs in investment property lending - and often where the customer is in fact advised by their accountant or financial planner not the broker.		Unintended consequences of not paying for complexity, potentially affecting (first time buyers) FTBs and investor lending where high LVRs are quite legitimate and have in the past represented up to 40% of broker volume
			At 70% the broker earns a similar commission to 80% so no incentive to push to the LMI level	If % differences are less than shown in Column D, LVR might ratchet up or down but when you apply the lower rate to the higher amount it still results in a higher aggregate commission		

				depending on loan size		
			Simple and measurable (existing metric)	Could steer brokers away from consumers such as FTBs that need their assistance most – due to lower reward for effort		
			Seeks to compensate brokers for lower commission on high LVR by providing higher commissions on low LVR	Disadvantages Insurers as puts further downward pressure on LVR, however that pressure is already there, and this measure is just aligning to it		
				Brokers that consistently write the majority of their business in high LVR loans will be disadvantaged - particularly if FTBs		
				Could encourage brokers to make greater use of limited guarantees from parties related to consumer		
1.8	**Pay upfront on loan size & LVR (Cap -say 90%)**	Only pay commission up to a 90% LVR cap except for First Time Buyers (FTBs) which are excluded	Removes the incentive to arrange LVRs above the cap	Does not discourage brokers pushing customers from say 70% to 80%	Yes	Concerns brokers would earn less and has no impact under 90%
			Aligns to prudential objectives and references in both the ASIC Rem Report and Sedgwick report to LVR. Regulator would argue lower LVRs are a good	Could result in brokers earning less which would need to be compensated for in a higher base starting point which lenders may be reluctant to do.		

			consumer outcome			
			Simple and measurable (existing metric)	May not adequately compensate for effort		
			Partially correlates to risk weighted capital - from 90% higher risk lower relative cost to originate (in reality cost is static from 90% whilst revenue increases)	Many high LVR loans are not poor outcomes. Often loans for medical professionals are high LVR and very complex in terms of personal financial structure or trusts requiring significant additional work which would not be compensated for in this instance to the extent LVR exceeds 90%		
			Simple and measurable (existing metric)	Does not fully compensate brokers for valid use of tax driven high LVRs in investment property lending - and often where the customer is in fact advised by their accountant or financial planner not the broker		
				Disadvantages Insurers as puts further downward pressure on LVR, however that pressure is already there, and this measure is just aligning to it		
				Brokers that consistently write the majority of their business in high LVR loans will be disadvantaged. Exclusion of first-		

				time buyers will however assist		
				Could encourage brokers to make greater use of limited guarantees from parties related to consumer		
1.9	**Pay upfront based on loan size & complexity (as proxy for effort)**	Pay higher commission for more complex deals and lower commission for less complex. Complexity could be based on income level and source	Rewards for effort	Complexity would need to be defined in terms that are as simple as possible so as to avoid over-complicating the calculation	Not on its own	Too complex when used with LVR and probably little benefit on its own. Complexity adds opportunity for dispute
			Can be used to moderate negative impact of LVR measure relative to effort	Only worthwhile if used with LVR, however if used with LVR then likely to be too complex		
				Does not compensate for effort on deals that do not settle i.e. effort does not necessarily lead to economic value		
1.10	**Link upfront and trail (or other aspect of rem such as broker clubs) to a quality measure (aspirational) - linked to recommendation 6**	As part of a cycle of continual improvement, there could be an industry wide quality metric that results from a standard industry audit and is linked to remuneration to encourage a culture of compliance and continual improvement. Would need to be standardised and portable. Ideally linked to consumer outcomes and compliance (responsible lending, interim assessment, file notes, justification for I/O etc.)	Obvious attraction is the self-assessment by the industry and continual improvement	Hard to standardise across industry both in terms of criteria and the way they are applied	No	Has a number of attractions but only realistic in time and if there is a degree of consistency in the industry. Fits more into recommendation 6 than recommendation 1 as more governance related

			Could use the quality measure to link to aspects such as entry to broker clubs	Very difficult to implement across the industry		
			Provides a more balanced scorecard	Risks subjectivity of assessor		
			Strong direct incentive to behave appropriately	As audit will be data/risk based could result in an above normal level of monitoring for customers that for example have high portion of investment loan/ high LVR business		
			Potential for better applications which is a good outcome for consumer, regulator, broker and lender			
1.11	**Standardisation of upfront**	All Lenders pay the same upfront %	Removes Lender based Conflict of Interest	Restricts competition	No	ASIC communicated with MFAA not looking to standardise or cap
				Limits ability to pay higher commissions for more complex products		
1.12	**Reduce Upfront/ Increase Trail**	Reduce upfront % and increase trail %	Could increase consumer confidence that more of the funds a broker receives is for service over time	Delays revenue and limits economic attractiveness for new entrants potentially reducing competition	No	Would reduce the attraction of becoming a broker
				Higher Barriers to entry		
1.13	**Flat Upfront Lender Fee plus % trail**	Industry pays an upfront flat fee regardless of loan size or broker location	Removes any incentive to boost loan size	No correlation to economic value produced by broker	Yes	Not viable for reasons shown

		Please note - Advantages and Disadvantages listed in columns E and F relate to upfront only	Easy to administer	Results in one broker cross-subsidising another		
			Correlates to effort	Results in a lender using high value deals to cross-subsidise low value deals (or pushing up APR on lower value deals to compensate)		
				Tiered flat lender fee could result in an even higher conflict of interest as one approaches next borrowing tier		
				Does not link lender costs to lender revenue		
				Linking remuneration to loan size has best alignment of objectives between Lender and Broker. Flat fee does not align objectives		
				Will discourage new entrants to the industry and reduce competition		
				Could results in split loans		
				No correlation to different broker cost structures around the country (e.g. Adelaide v Sydney)		
				Could make broking non-economical in certain jurisdictions		
				If the objective of a flat fee is to correlate to effort, it however ignores the effort put in on deals		

				that do not settle		
				Small loans/top-up loans would be non-economical for lenders and could be compensated for by higher interest rate or application fee to consumer which would be a potentially poor outcome		
1.14	**Collar**	Combines a flat basic fee for a base amount, e.g.; $300k and then a percentage between $300k and a selected loan maximum.	Partially removes the focus on loan size, but only for loan sizes that are below or above the collar	Will disadvantage certain brokers that write high value loans	Only discourages larger loans above the maximum	Limited link to economic value
				Only partial correlation to economic value produced. Not correlated where loan size is above or below collar		
				Results in one broker partially cross-subsidising another		
				Does not link lender costs to lender revenue		
				Linking remuneration to loan size has best alignment of objectives between Lender and Broker. Collar only partially aligns between collar limits		
				May discourage new entrants to the industry and therefore reduce competition		

				Uneven correlation to different broker cost structures around the country (e.g. Adelaide v Sydney)		
				Suffers from a number of the same disadvantages described in 1.3 above but to a lesser extent		
				Can't be equally applied to all states		
				Small loans/top-up loans would be non-economical for lenders and could be compensated for by higher interest rate or application fee to consumer which would be a potentially poor outcome		
1.15	**Remove lender APR discounts for loan size**	Currently Lenders offer discounts to customers for higher loan sizes which incentivises brokers to increase loan size. **Note** - Other measures in 1.2 and possibly 1.4 likely to remove the need for this one	Would discourage loan size	Removing these discounts would more likely be a poor outcome for consumers who may benefit from borrowing a small additional amount	Yes	Creates conflicting objectives for the broker, on the one hand they are providing advice that reduces the consumer's APR which is a great outcome but on the other hand they are suggesting a larger loan size which regulator may see as a poor outcome. If there is a measure introduced to pay net of offset and/or additional disclosure on offset amounts then that should negate any benefit to the broker from this behaviour and remove the need to

						cease this type of Lender offer (a good consumer outcome is obtained and broker is not rewarded for the behaviour unless funds are drawn within 6 to 12 months). If no offset measure is agreed, then greater consideration needs to be given to this one
1.16	**Removal of brokers ability to reduce customer application fee/Interest rate by discounting upfront commission or trail**	Having this ability presents a conflict of interest and consideration can be given to removing	Removes conflict of interest	If implemented would result in a consumer not getting a reduction in application fee or interest rate which is likely to be a poor outcome	No	Consumer benefit likely to outweigh the conflict in terms of advantages/disadvantages
				Brokers could in any event rebate the fee themselves so in reality no point in implementing		

1.17	**Adjust lender accreditation removal to include retraining step**	Removal of lender accreditation of a broker to be reviewed to ensure that hard edge is removed and another step is introduced in the process. Terminating for conduct, quality and educational purposes is fine, but we need an alternative (e.g. further education) for usage/volume as this impacts a broker's ability to service existing clients and can result in behaviour that diminishes choice. One alternative is that a broker needs to complete additional training or re-education by a certain period and that their accreditation can only be removed if that doesn't occur. But clearly there needs to be balance in the discussion	Removes potential reduction in consumer choice in order to maintain accreditation		No	"Hard edge" needs to be removed to ensure consumer choice is not impacted and that brokers can service their back book
			Will ensure a broker can service existing clients with a particular lender			
1.18	**Referrers need to be more actively regulated**	Referrers are paid too much relative to what they do with too little regulation and minimal duty of care. Playing field needs to be levelled	Would level the playing field between brokers and referrers and also potentially strengthen consumer outcomes			

7.3 Appendix 3 CIF reforms

ASIC's Proposals	Reforms	Impact
1. Changing the standard commission model to reduce the risk of poor customer outcomes [Sedgwick recommendation 18]	The industry recognises the potential for financial incentives to put good customer outcomes at risk where they encourage customers to borrow more than they need. The CIF considers that industry participants may address this risk by adopting the following remuneration principle: *"To the extent that remuneration relates to loan size, remuneration should relate to the funds drawn down and utilised by a customer."* The industry considers that this principle would be satisfied where, for example: Upfront commission is paid on a utilisation basis, that is: - Based on facility limit drawn down by the customer, and - In cases where the loan has an offset account, on the amount drawn down net of offset account balances. Trail commission is paid on the amortised drawn down amount net of offset account balances or based on facility utilised, and Clawbacks remain part of the standard commission structure. Generally, funds drawn down would be measured and commission paid on initial settlement and at a later point in time for subsequent drawn down amounts, up to the maximum facility limit. The CIF recognises that this approach to funds drawn down and utilised may require further consideration in certain limited circumstances, such as residential construction lending.	The current standard commission model includes upfront commission paid on settlement of the loan, as recognition of economic value created by the broker for the lender, and trail commission paid over the life of the loan, which supports the broker to provide ongoing service to their customer base over time. ASIC "found it common for remuneration structures to pay commissions on the total amount of borrowing approved, rather than the amount of funds drawn down"[27]. We believe the principle to pay commissions based on the funds being utilised by the customer directly addresses the biggest risk to consumers arising from product strategy conflict. Mortgage brokers will no longer be paid on facility limits or have a financial incentive to recommend larger loans that initially have large offset balances. The CIF have proposed this principle to promote good customer outcomes, specifically to ensure the appropriate size of the loan for customers and to discourage large initial offset balances. When coupled with the governance framework proposed, this is a significant step forward. The CIF made a rigorous assessment of the potential customer outcomes of a number of remuneration models and their variants, which were deemed to have potential unintentional consequences for customers. These identified unintended consequences generally affected first home buyers most.

[27] ASIC Report 516, 'Review of mortgage broker remuneration', section 30, p.10.

	As long as this principle is satisfied, there should be no restrictions placed on lenders adopting additional methodologies of calculating commission payments. Additional arrangements for the eligibility of trail commission based on customer outcomes are set out in proposal six. **Implementation by end 2018**	The models and their variants could largely be placed into five main categories. The models were all evaluated by the CIF based on the schedule contained in the MFAA submission (MFAA Submission), and were all found to have unintended consequences some of which are detailed below. The main categories and their potential unintended consequences include: Consumer paid fee for service (in lieu of commissions): While consumer paid fee for service may reduce lender choice and product strategy conflicts, it will negatively impact competition and customer outcomes; result in additional direct costs to consumers to access the broker channel; diminishes the broker value proposition to the customer; put brokers at a significant disadvantage to the lender branch channel (who do not charge direct fees); likely result in rationalisation of broker numbers, increasing barriers to entry for new lenders, whilst disadvantage smaller lenders and those without a branch footprint; is unlikely to correlate to economic value produced by the broker; and could result in brokers servicing a much narrower band of customers. Standardisation of upfront commission percentage: while it may reduce lender choice conflict, by itself, it would not reduce product strategy conflict. Further, this method does not differentiate for complex products and may raise competition law issues if implemented by industry agreement. • Base commissions paid on Loan Value Ratio (LVR): may exclude high LVR lending, for example to first time home owners and could encourage the greater use of guarantees from related parties to reduce LVRs. • Flat lender fee: could result in brokers servicing a narrow band of customers, for example, those with simple needs. It may not reduce product strategy conflict in the case of tiered fees. It has no correlation to economic value produced. Also, it could negatively impact pricing on smaller loans. Finally, it

		may result in split loans for customers if ‘gamed’. • Removing lenders’ and brokers’ ability to discount interest rates and application fees: this may limit loan size but also reduce direct customer benefits. Adopting this principle is a first step for the industry. The industry intends to use the improved governance framework to closely monitor customer outcomes and the impact of the reforms. Where remuneration structures are found to be driving poor behaviours and customer outcomes, the industry will consider further changes to remuneration structures.
2. Moving away from bonus commissions and bonus payments which increase the risk of poor customer outcomes [Sedgwick recommendations 16. a) and 16. c)]	The industry recognises the potential for volume-based bonus commissions, campaign-based commissions and volume-based bonus payments paid by lenders and aggregators to brokers or by lenders to aggregators to put good customer outcomes at risk. The industry also recognises ASIC’s expectation that the industry moves away from these commission and payment structures. All industry participants should respond to ASIC’s recommendation by 31 December 2017. In practice, many industry participants have already taken individual decisions to cease these payments. The industry recognises that volume-based payments from lenders to aggregators can also raise conflicts. Financial support, provided by lenders to aggregators, for compliance education and training that lead to better customer outcomes is not likely to raise conflicts as long as these are not based on volume of loans written with any particular lender and do not form a condition of being	ASIC noted that volume-based and campaign-based commissions that supplement the standard commission model can create potential conflicts of interest and “higher risk that brokers will place customers with lenders for the wrong reasons”[28]. The changes proposed are considered to reduce this risk of lender choice conflict. From a customer perspective, this provides a clearer pathway for brokers to “match [their needs] with the right home loan product and lender”[29]. Again, the change to broker conduct and culture from this proposal will be supported through changes to the governance framework. We also note that ABA member banks are addressing bonus payments to their staff through commitment to implementing the Sedgwick Recommendations.

[28] ASIC Report 516, ‘Review of mortgage broker remuneration’, section 119, p.24.
[29] ASIC Report 516, ‘Review of mortgage broker remuneration’, section 21, p.8.

	on the aggregator's panel of lenders. Discounted or free aggregation as a result of writing aggregator white label loans, or any specific lender's loans, has been removed from the industry, and the industry does not support the return of this practice. While not a change specifically proposed by ASIC or Sedgwick, this move demonstrates the intent of the industry to address areas of potential conflict that may not result in good customer outcomes. **Implementation by end 2017**	
3. Moving away from soft dollar benefits which increase the risk of poor customer outcomes and can undermine competition Specific areas considered: • Tiered servicing (Broker Clubs) • Conferences/Professional development events • Entertainment and Hospitality	Tiered servicing Access to a Lender or Aggregator's tiered service model should be determined using a balanced scorecard, with a maximum 30% volume component, as a proxy for productivity, as well as other criteria aligned to 'Good Customer Outcomes'. Access to a tiered service model will be disclosed by the broker where they are recommending a product from that particular lender. Such programs should not entitle brokers to preferential customer discounts or to additional payments or commissions. Instead, these programs should provide preferential service which can assist customers in achieving better outcomes. Conferences and Professional Development Professional development and most education is available to all brokers to ensure ongoing competency and professional development. All conferences and professional development events must be educationally focussed (with a minimum of 80% identified education content) and aimed at continually improving customer outcomes.	The industry intends to reduce potential for both lender choice conflict and product strategy conflict through these changes. These changes are expected to continue to improve customer outcomes through promoting a strong base level of competency across brokers in the industry and a risk and regulatory focus through use of balanced scorecards. Disclosure of conflicts of interest registers to customers, combined with disclosure changes under proposal five, will help increase transparency and reduce potential for lender choice conflict. Removal of volume from eligibility scorecards directly manages strategy conflicts by removing incentives to write larger loans that are not utilised by the customer. Again, combined with changes under proposals five and six, implementation is intended to lead to improved conduct and culture.

[Sedgwick recommendation 16. b)]	Minimum education and professional development for brokers is not considered a reward but as driving a level of competency to improve customer outcomes. Locations for conferences and professional development must be business appropriate and not likely to cause reputational harm to the industry. In some circumstances, additional education opportunities are offered. Broker access to these additional opportunities should be based on a balanced scorecard, which does not include volume. <u>Entertainment and hospitality</u> The industry recognises that the provision of high-value entertainment and hospitality may raise the risk of lender choice conflicts. The industry considers that this risk may be addressed by ensuring that lenders do not provide entertainment or hospitality to mortgage brokers that has a value of more than $350 per person, per event. This value was chosen to align with FBT reporting, which enables lenders and aggregators to use existing reporting for better monitoring and supervision. Aggregators will not determine eligibility for entertainment or hospitality, wholly or partly, on the volume of loans written with any one lender or white label loan product. For entertainment or hospitality above $100, lenders, aggregators and brokers will be required to maintain their own register of entertainment and hospitality benefits (given or received) on a rolling 12-month basis, with records kept for three years. ‘Entertainment and hospitality’ does not include professional development and education events, that have more than 80% identified education content and are offered in a business appropriate location. This register should be kept current, advertised in the	

	Credit Guide provided to customers and monitored by aggregators and details provided on request. Lender Sponsorship of Aggregators and Events Sponsorship opportunities to an aggregator event should be made available to the aggregator's entire lender panel. As above, the aim of any event is to increase education. Further, the ability to join an aggregator's panel should not be contingent on the level of sponsorship provided. **Implementation by end 2018**	
4. Clearer disclosure of ownership structures within the home loan market to improve competition	To reduce the impact of ownership structures on competition in the home loan market, we propose that participants in the industry more clearly disclose their ownership structures and other circumstances in which they may have the ability to exert influence. Disclosure of ownership structures will be required if 'Significant Influence', as guided by the definition in Australian Accounting Standard 128 (AASB 128), is deemed to be exerted over a participant in the industry. Disclosure of ownerships structures would be required where, for example: Ownership is 20% or greater, or, Where ownership is less than 20%, a board seat is held or a white label product is offered by a substantial shareholder (as defined). Disclosure of ownership structures should extend beyond mortgage brokers and apply to all players in the home loan distribution chain, including lenders and aggregators. Disclosure of ownership structures should be included in marketing material, digital formats and at all distribution points (e.g. websites and at physical premises). The CIF suggests carrying out customer testing of disclosure formats and standards (once designed) to	The disclosure of ownership structures, combined with the proposed changes under the public reporting regime, is expected to reduce the risk of lender choice conflict for customers and improve competition in the industry.

	ensure clarity and maximum benefit.	
5. Establishing a new public reporting regime of customer outcomes and competition in the home loan market [Sedgwick recommendation 19]	Below, the CIF proposes providing particular information to ASIC and would like to work with ASIC on approaches to de - identify and aggregate the information, for publication. Aggregators to publish and provide to ASIC: List of all lenders available on panel and percentage share of business written with each over the previous financial year, Spread of number of lenders being used by brokers in the group/aggregator (in the last 12 months): % brokers using < 3 lenders, % brokers using 4 – 7 lenders, % brokers using 8+ lenders, and Weighted average commission rate percentage earned in the previous financial year for mortgages. Lenders to provide to ASIC: Weighted average pricing of home loans (across established scenarios) in the previous financial year across their different distribution channels using a standard scenario (final figure). Further work is required with ASIC and the industry to agree a standard model to analyse and present the pricing information, particularly taking into account variables such as the effect of interest rate movements. Brokers to publish to customers: List of lenders available to the customer via the broker's aggregator, Number of lenders used in the previous financial year, and Top 6 lenders and % of business written in the previous financial year (Note: if the individual broker has not been in business for 12	The proposed disclosures and measures are to be tested with consumers and ASIC to evaluate whether they make a meaningful difference to reducing the potential for lender choice conflict and increasing financial literacy. Once clear disclosures are developed, the CIF believes that the proposed disclosures will help customers when navigating the home loan process. By providing them with transparency around the lenders used by brokers, it enables a customer to question whether they have been matched to the right home loan product and lender. Again, when combined with other proposals, the changes are expected to improve broker conduct and culture through providing transparency of use of lenders on an aggregator panel.

	months then this would be N/A).	
6. The industry needs to improve the governance and oversight of brokers by lenders and aggregators [Sedgwick recommendati on 17]	The industry proposes introducing an improved Governance Framework under which the industry would self-assess, self-correct and continuously improve. This framework would comprise: Key Risk Indicators, which would act as triggers/flags for potential poor customer outcomes, Unique identifiers, to allow for more complete reference checking and identification of poor performers, Annual reviews of individual aggregator and broker governance frameworks, Data based broker monitoring, Customer feedback and shadow shopping to ensure reforms are ensuring good customer outcomes, Reporting and ongoing review of remuneration structures, including upfront, trail and clawbacks, to the extent they negatively impact customer outcomes, and Remediation, such as training, education, and recognition. This work is already underway and will be ongoing. *Key Risk Indicators* Key Risk Indicators would need to be reported from Lender to Aggregator/Broker around the potential for a poor customer outcome. These indicators provide data-based direction to the allocation of oversight effort and resources and could/would include the following relative to the industry average: % of portfolio in Interest Only, as an example of a product and whether for investment or owner occupier purposes, Arrears (60+ days or average weighted arrears in the first 12	The proposed changes are expected to improve conduct and culture across the industry, and hence improve customer outcomes. Prioritisation of elements of this model is the next step for the CIF, to ensure continuous improvement does not stall. The industry is committed to the change and is continuing to work together around how and when this can be implemented given the materiality of the change and constraints of individual technology and systems. The Governance Framework has the following features: The governance changes underpin all the entire reform package, The changes will focus on better understanding of the broker – customer conversation and needs analysis, including the customer interview guide, to drive a higher and consistent level of practice, The changes improve data driven information sharing between lenders and brokers to improve monitoring, supervision and ID of poor customer outcomes, and Identified issues will feed into Professional Development and education plans.

	months), "Switching" in the first 12 months of settlement, Elevated level of customer complaints, Poor post settlement customer survey results of the broker experience, and The quality of the loan, identified through any deficiencies found in Requirements and Objectives (R&O) documentation which would include moving to a more robust capture of the R&O by the lender as a separate initiative (potentially through establishment of an Industry Guide for capturing such information). *Unique Identifiers* The industry intends to work with Government to implement a Unique Identifier for each broker and introducer/referrer to bank, noting there is investigation required around how this can be implemented. The unique identifier should be held on a 'register' of brokers maintained as a reference checking protocol for credit professionals moving between aggregators or moving from working with a lender to an aggregator. Ideally this identifier would be maintained throughout a person's career across financial services industries, such as financial planning, mortgage broking, referring / introducing and as a lender employed banker, and be managed centrally by ASIC. Once fully implemented this identifier would be used by aggregators, lenders, associations and ASIC, and be held against all loans lodged at the lender level to assist with data analytics. *Customer Feedback* There should be ongoing customer feedback gathered to review whether a 'Good Customer Outcome' has been achieved. An industry standard to obtain this feedback needs to be designed but would become integral to the aggregators' monitoring of brokers, creating a 'test and	

	learn' environment. *Remediation* In conjunction with proposal one, and along with training, education and recognition, the industry considers that good customer outcomes are promoted by withholding the **trail** commission if: A loan is 60+ days in arrears, and/or A loan is found to have been calculated using inaccurate information allowing a customer to receive a larger loan (trail not paid if any fraud found in the application), and/or A loan is refinanced or restructured, which may be potential evidence of not being fit for purpose. **Implementation end 2020**	