14 March 2016

Broker Remuneration Review
By email: brr@asic.gov.au

To the Mortgage Broker Remuneration Review Project Team,

Re: Comments on Scoping Discussion Paper

CHOICE welcomes the opportunity to provide comment on the Review of Mortgage Broker Remuneration, Scoping Discussion Paper.

We are concerned about the proposed research methodology for this project. To CHOICE's knowledge, there are no plans to conduct case study work, shadow shops or file reviews. Without examining the nature of the advice given by brokers to consumers, the proposed methodology is unlikely to capture whether mortgage brokers met consumers' goals and if high pressure sales tactics or upselling occurred.

There is an inherent conflict of interest in the broker remuneration model. The broker acts for a consumer but is usually paid by credit providers. The goal of this review should be to determine if remuneration models, particularly commission-based remuneration models, lead to:

- Consumers being steered into higher cost loans;
- Consumers being encouraged to arrange larger loans (whether unsuitable or simply larger than the consumer intended);
- Consumers being encouraged to take on greater risk than intended such as arranging a loan with a low loan-to-value ratio, having family members guarantee a loan or taking a loan against a family home to fund an investment property;
- Brokers choosing from a limited number of lenders based on commissions or other incentives; and
- Brokers providing lenders with incorrect information about clients, particularly about budget and expenditure.

CHOICE's mortgage broker shadow shop points to issues with sales pressure and risky advice

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CHOICE conducted a shadow shop in early 2015 where we sent five home buyers to three of the biggest mortgage broker businesses in Australia: Aussie Home Loans, Mortgage Choice and Australian Finance Group.

CHOICE recognises these case studies are not statistically significant. They instead provide rich qualitative data that point to likely problems consumers are experiencing. We encourage ASIC to use the results of the CHOICE shadow shop as a starting point to develop hypotheses to test using other research methods and to expand on through additional qualitative work in this project. A copy of the CHOICE shadow shop report is attached for reference.

The shadow shop found three major problems.

1. Clients were not well-informed about the size or nature of the commissions that brokers receive.

Only two of the fifteen brokers explained unprompted that they received commissions and which lenders they dealt with. Others provided some information about commissions or the lender panel. No consumer could easily confirm and compare commissions their broker would receive for arranging different loans. Failure to disclose commissions at the commencement of the broking process creates the risk of consumers not understanding that the business model has a fundamental conflict; that brokers are paid by lenders and can be incentivised through commissions to offer particular loans.

2. The quality of some broker recommendations was poor and some brokers encouraged consumers to pursue risky borrowing strategies. Some mortgage brokers failed to adequately assess the needs of clients and alert them to risks.

Our shadow shop found pressure sales techniques, inappropriate advice and upselling with little consideration of risk. Brokers should have an obligation to educate consumers not just to sell products. No broker in the CHOICE study had a direct conversation with clients about capacity to pay should interest rates rise. This is particularly concerning as rates are at record lows and rate increases should be expected over the life of any mortgage taken out today.

3. Mortgage brokers help arrange credit for the largest purchase most people make, a house. Yet, brokers are only required to arrange a ‘not unsuitable’ loan, not the best possible loan.

Consumers are likely to seek the best loan for their circumstance, not just a ‘not unsuitable’ loan. While responsible lending obligations are an important protection, further consideration is needed to assess whether brokers should also be required to place client’s needs ahead of their own at all times. None of the recommendations given to CHOICE shadow shoppers were uncompetitive but there were better deals available. Consideration should be given to what consumers expect of a broker: do they expect a good or the best loan for their circumstances?

Response to scoping questions

2. Are there any home lending market participants that you consider should or should not be examined as part of this review?
Industry participants who receive payments for referring clients to brokers or lenders should be considered in this review. This includes accountants, financial advisers, developers and real estate agents.

5. Are there any other matters you feel beneficial for consideration?
The review should take into account why consumers choose one lending channel over another and how they found out about their particular lending channel. This data will be particularly useful when looking for solutions to any problems identified in the review. For example, if there is a mismatch between what consumers expect of brokers and what service is delivered it will be important to know if consumers made decisions to use a broker based on advertising, word of mouth or referral from another professional.

ASIC should also consider construction loans as part of the project as these are often complex and require specific guidance from brokers.

11. What factors do you consider we should prioritise in assessing consumer outcomes?
ASIC cannot just measure consumer expectations and experiences of mortgage brokers. This must be combined with a rigorous assessment of the outcome and the quality of the advice provided by the broker. The factors that should be considered when assessing consumer outcomes are:

- The quality of the loan arranged. Was there a better loan available through the broker's panel? Was there a better loan available in the market? Consideration should be given to the cost of the loan as well as whether the features of the loan met the client's needs.
- The size of the loan arranged. Did the consumer intend to borrow as much as the broker recommended?
- The risk appetite of the client and whether broker recommendations matched client needs.
- If and when a client was given a credit guide and informed of any commissions a broker would receive, including different commissions that could be received for different loans.

- If the overall strategy pursued met the intentions of the client before they saw a broker and the needs of the client.

13. What information gathering methods do you consider would best assist us to identify:

- **The factors and priorities which drive consumers to apply for home lending products through particular distribution channels?**
- **Consumer expectations of, and experiences with, particular home lending distribution channels and their respective sales processes?**
  The influence or impact (if any) of remuneration structures on consumer decision making and outcomes?

Based on discussions with ASIC and the information presented in the scoping document, CHOICE is concerned that this project will rely too heavily on data provided by industry. To assess consumer outcomes, evidence should include:

- Shadow shops of mortgage brokers.
- Interviews with consumers (focus groups and/or case studies).
- Surveys of consumers.
- File analysis.

It is extremely important that discussions with consumers about their experience with mortgage brokers looks beyond their assessment of the quality of the broker. CHOICE's shadow shop found that in many cases a consumer gave a high rating to a mortgage broker but experts concluded that the advice given was risky or that loans recommended were not good quality. This is similar to ASIC's findings about financial advice quality. A 2012 ASIC shadow shop of retirement advice found that 39 per cent of advice was poor, 58 per cent was adequate and only 3 per cent was good yet 86 per cent of consumers said they trusted the advice they received 'a lot'.[1]

In addition, discussions with consumers must occur before and after a consumer has contact with a broker. This is the only way to accurately capture any influence a broker may have, positive or negative, on a consumer's perception of the market and their borrowing strategy.

CHOICE notes that any comparison of consumer experiences with different home lending distribution channels will need to take into account that all channels include incentives which may lead to poor consumer outcomes. For example, staff in bank branches have key performance indicators that can be linked to volume or number of loans, some may have sales targets and may receive commissions or other kinds of conflicted remuneration.

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[1] ASIC (2012), *Report 279: Shadow shopping study of retirement advice*, p 8, 54.

Finally, it is essential that this project includes some kind of independent comparison of the advice mortgage brokers provide. Most Australians will take out one home loan at a time. Very few will see more than one mortgage broker, so they have no way of comparing the quality of the experience. The only way to provide an objective, contextual and comparable assessment is to include a component of expert assessment of the actual advice provided by brokers. CHOICE believes this is best achieved through a shadow shopping exercise.

For further information, please contact CHOICE on eturner@choice.com.au.

Yours sincerely,

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