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INQUIRY INTO PROPOSALS TO LIFT THE PROFESSIONAL, ETHICAL AND EDUCATION STANDARDS IN THE FINANCIAL SERVICES INDUSTRY

BRIEF EXPLANATORY SUBMISSION BY THE MORTGAGE AND FINANCE ASSOCIATION OF AUSTRALIA (MFAA)

October 2014

Preamble

As the members of the MFAA do not operate in the financial services industry in that they do not provide a 'financial service' as defined by the Financial Services Reform Act, the MFAA has not previously provided a submission to this Inquiry. We are, however, responding to an invitation from the Committee Secretary to appear in this Inquiry.

The MFAA

The MFAA is the peak professional association for mortgage and finance brokers (under the association's accreditation scheme known as 'credit advisers') with 10,700¹ members across Australia. The vast majority of our members are mortgage brokers, who since 2010 have been regulated by the National Consumer Credit Protection Act (2009). Prior to that they were regulated by a patchwork of state regulation in WA, NSW, ACT and Victoria with no specific regulation in Queensland SA and NT. MFAA was a strong supporter of national legislation and had been lobbying for that since 2002.

Mortgage brokers have been around for about thirty years but really only started to flourish after 2000. However their services have been embraced by consumers such that now they are responsible for 50%² of all residential mortgages. The following table 1 demonstrates their growth:

¹ It is estimated that this represents about 75% of all mortgage and finance brokers in Australia

² Source: MFAA Quarterly survey of leading mortgage brokers and aggregators (Aug 2014) by *comparator*.

Table 1: Mortgage Broker Market Share Growth

	Broker Market Share
1992 – 2001	15-20%
2002 – 2006	25-40%
2007 – 2008	38%
2009 – 2014	40-50% [2014: \$140billion]

Research by *brandmanagement* in 2012 shows that there is a high consumer awareness of mortgage brokers (**95.9%**) and 82.2% know exactly what a broker does. The research also indicated why consumers choose to deal with brokers, viz

- “they do all the leg work for you” (78.6%),
- “they have a wider loan range” (76.6%),
- convenience” (74.2%)
- “they are experts in a range of mortgages from numerous lenders” (70.6%).

Because mortgage brokers provide credit advice about a range of different products across a range of lenders, bank and non-bank, large and small, they have had the effect of diffusing somewhat the concentration of home loans with the Big 4 banks, (see table 2).

Table 2: How Brokers Drive Competition

2014	Non broker loans	Broker loans	All loans
Big 4	82%	74%	78%
Other lenders	18%	26%	22%

Source: MFAA calculations based on *comparator – Broker Market Share statistics, June Qtr 2014; APRA Monthly Banking Statistics – June 2014; ABS Housing Finance 5609.0 – June 2014.*

This shows that a consumer is less likely to be recommended a product with a Big 4 lender by a broker than if they sourced the product directly (74% v 82%).

Another interesting characteristic of broker initiated loans, according to NAB³, is their general superiority to branch initiated loans as the following metrics demonstrate:

- Broker loans – higher quality than branch loans
 - Delinquency better or equal to branch loans
 - Average size higher and tenure longer
 - Borrower personal and family income higher
- Broker customers younger
 - 56% under 40 (branch 48%)
 - 57% uni-educated (branch 48%)
 - 74% fulltime employed (branch 65%)

³ Paper delivered by head of NAB Broker, March 2013

History of Regulation of Mortgage Brokers

Mortgage Brokers were originally regulated in WA in the 1970s and subsequently in the 90s and following years in NSW, ACT and Victoria. However in the absence of national uniform regulation, the MFAA in 2000 developed an internal regulatory regime which involved compulsory membership of an External Disputes Resolution scheme, Mortgage Industry Ombudsman Scheme, which was the forerunner of the current Credit Ombudsman. In 2003 a Code of Practice was promulgated along with Disciplinary Rules. These initiatives provided higher standards and consumer protection than were provided by the legislation. It has always been the Association's policy to have internal regulatory standards which are higher than those imposed by legislation and in respect of the MFAA's current standards ACCC has commented in its 2014 authorisation review of the MFAA Disciplinary Rules⁴:

"ASIC notes that the MFAA requirements cover a wider area of credit products. For example, ASIC submits that the NCCPA regulates consumer credit only, whereas the MFAA Code covers all credit activities engaged in by its members including small business and commercial equipment lending."

ASIC also notes that higher minimum qualifications are required for MFAA mortgage broking members to obtain membership, and submits that the MFAA provides a mentoring program that is designed to provide support for new entrants into the industry. ASIC considers that industry organisations can play an important consumer protection role in raising industry standards, and in investigating and appropriately responding to instances of member misconduct."

"The ACCC accepts that the Disciplinary Rules provide a mechanism for the MFAA to impose a higher standard than that prescribed under the NCCPA, including the regulation of credit activities relating to small business and commercial equipment lending.⁵ This is likely to result in benefits to consumers beyond that which legislation alone can achieve."

"The ACCC considers that the MFAA can complement the work of the industry regulator and other professional industry associations to promote best practice in the mortgage and finance industry. The ACCC notes the MFAA's submission that ASIC cannot be expected to pursue every issue. Further, that the bulk of matters finalised by the Tribunal are not matters being considered by ASIC, often because the conduct is not an offence under the NCCPA or it is not seen as a priority matter for ASIC."

"The ACCC is of the view that public benefits are more likely where the professional standards are higher and cover a wider area of credit products than that legislated by the NCCPA."

"The ACCC considers that the extent to which the public benefits of higher professional and ethical standard of conduct and compliance for members are likely to result depends upon the extent to which the Disciplinary Rules regulate the behaviour of MFAA members through effective enforcement mechanisms."

⁴ Determination: Application for revocation of authorisation A91118 and substitution with A91396 lodged by Mortgage and Finance Association of Australia

⁵ a. The NCCP requires that a loan, lease or refinance is 'not unsuitable'. The MFAA standard is that such a loan must be 'appropriate'.

b. The NCCP requires completion of a relevant Certificate IV (or higher) qualification as specified in ASIC's *Regulatory Guide 206*. The MFAA requires a member to complete a Diploma in Mortgage and Finance Broking Management (or equivalent) or higher relevant qualification.

c. The MFAA notes that ASIC may issue an Australian Credit Licence (ACL) to a person who has 'serious fraud' in their history provided that the fraud is older than ten years. The MFAA advises that it is unlikely to approve a membership application from a person who has a serious fraud in their criminal history and the Disciplinary Rules allow the Tribunal to decline such an application.

d. The MFAA's membership criteria also require that loan writers must hold individual membership. This effectively extends the requirements of the MFAA Disciplinary Rules on ACL holder members to encompass their entire loan writer membership, *not* just the ACL holder members. The MFAA's disciplinary regime extends vicarious obligations on employer members over their employee's activities and consequently treats licence holders, their employees and appointed contractor members alike.

“The ACCC notes that the MFAA has continued to investigate non-compliance with the MFAA Code and take disciplinary action since the NCCPA was introduced.”

“The ACCC is of the view that the MFAA disciplinary regime operates an effective enforcement mechanism, by investigating non-compliance and applying sanctions in the appropriate circumstances, to provide a strong deterrent against professional misconduct for MFAA members, in addition to the regulatory role of ASIC”.

For the record, it should be noted that since inception of the MFAA Disciplinary Rules in 2003, 44 members have been expelled or had their membership cancelled and 32 suspended⁶. In many cases these have resulted from fraud or dishonest conduct against a lender⁷.

While the focus of MFAA standards has been on ethical and professional conduct, they also embrace education standards.

In 2009 MFAA required all members to hold at least Certificate IV in Finance Broking/Mortgage Broking and ceased the membership of some 1100 members⁸ who did not satisfy the standard and in 2013, further ceased the membership of 1500 members⁹ who had not satisfied a new standard required by the association, viz Diploma in Finance and Mortgage Broking Management.

In each case these education standards were higher than required by legislation. Since June 2014 NCCP has required Certificate IV level, compared to MFAA's higher Diploma standard. Currently the Diploma is the highest level education program available for mortgage and finance broking in Australia. It is worthwhile noting that MFAA's requirements exceed the regulatory education standards required of lender staff by NCCP.

Since the new MFAA education standard has been in place we have focussed on mentoring programs so that members are better experienced and equipped to handle all issues that might confront them. This recognises that education standards in themselves are not enough. All members who join without at least two years' experience are required to undergo a mentoring program until two years has elapsed. We recommend that new members undertake their mentoring through an MFAA Certified Mentor, who is specifically qualified to mentor new brokers on the running of the broking business, which includes all aspects of ethical behaviour and general experience.

As indicated, MFAA was a strong supporter of national regulation and we went to the Government of the day in 2007 with a three pronged proposal, viz:

- National regulation
- Industry wide coverage (not just brokers, but including all sources of credit advice, eg banks building societies, credit unions and others)
- Separate legislation from Financial Services Reform Act (FSRA)

⁶ These are shown on the MFAA website and notified to ASIC. Sanctions imposed have included, but are not limited to: expulsion, suspension of membership, membership cancellation, compliance orders, corrective action, financial contribution to the MFAA, additional training, and audit of operations. For matters where the MFAA imposes a suspension, expulsion or cancellation of MFAA membership, the MFAA generally describes these matters as 'severe'.

⁷ Examples of 'misconduct' which have been the subject of disciplinary proceedings: false documentation, false declarations on membership application or renewal forms, misleading borrowers, inappropriate loans, unprofessional behaviour, and misleading or deceptive conduct.

⁸ Some 700 who subsequently complied, were re-admitted.

⁹ Some 400 who subsequently complied were re-admitted

Industry wide coverage

Initially there was a view that the Federal Government should follow the state-based legislation and only regulate brokers however we argued that it was 'crazy' to regulate the advisers (brokers) but not the providers of credit (lenders).

Separate legislation from Financial Services Reform Act (FSRA)

We argued that there is a considerable difference between the services provided by financial advisers and brokers (credit advisers).

The basic difference is the direction of the 'money flow'.

In the case of a financial adviser, money owned by the consumer is advised to be invested in a range of possible investments. The money flows away from the consumer to the investment.

In the case of a mortgage broker, the money flows from a lender (based on a recommendation or credit advice from the broker to the consumer) to the consumer as the borrower. However while the broker may make a recommendation or provide credit advice to the consumer, the decision to lend the money is made by the lender, which 'owns' the money.

Clearly the transaction is different and so is the risk. The Government recognised the inappropriateness of having both these regulated under the same rules. Accordingly the provision of credit and credit advice is regulated under the NCCP.

However while MFAA has placed a strong emphasis on education standards, we are conscious of simply raising standards for standard's sake. The standards must be relevant to improving professional conduct and consumer protection. Supporters of further higher standards need to be able to demonstrate which 'wrong' they are attempting to remedy.

It should not escape the notice of the Inquiry that the mortgage broking channel has had no 'Westpoint', 'Storm' or 'CBA-type Financial Planner' disasters. We think that has a lot to do with the nature of the risk and the appropriate standards, both government and MFAA, regulating that risk.

The conduct of mortgage brokers is robustly governed by the provisions of the *National Consumer Credit Protection Act, 2009*. They are required to disclose commissions, lender panels and, in particular, to ensure there is no disadvantage to clients as the result of any conflicts of interest they may have. Unlike other legislation, e.g. *Corporations Act 2001* (Cth) which requires an AFSL holder to 'have in place adequate arrangements for management of conflicts of interest' i.e conflicts may be managed by disclosure, brokers under the NCCP are required to take individual responsibility to ensure there is no consumer disadvantage and not simply disclose the conflict.

The CCLSWA submission

In preparing this submission, another submission to this Inquiry from the Consumer Credit Legal Services (WA) Inc [CCSWA] has come to our notice.

This CCLSWA submission is based on the erroneous premise that brokers are *'in the financial services industry'* and incorrectly states *'in this submission we use the terms 'financial adviser', 'mortgage broker', and 'broker' interchangeably'*.

The submission states: *'...the law should impose more stringent regulations for brokers in the financial services industry to lift the professional, ethical and education standards of the industry'*.

It seems this statement has been made without any understanding of what the current laws provide (putting aside the fact the brokers are not in the 'financial services industry').

While a consumer may make a decision to enter into a loan based on advice from a broker, the critical point in the process is whether the lender will agree to lend the money. Apart from satisfying their own risk appetite, the lender must also satisfy themselves under the NCCP, that the loan is 'not unsuitable' for the borrower. In the case of a broker who is an MFAA member, the test is higher. They must satisfy themselves that the loan is appropriate to the borrower's circumstances. The NCCP also requires brokers to disclose commissions and their panel of lenders to the borrower. The notion that brokers steer loans because of the likelihood of a higher commission is an 'old chestnut' that does not hold up. Most lenders pay very similar commissions in any case so there is no incentive to steer. A few basis points is neither here nor there to the broker. Further the key factor is determining which lender to recommend is how quickly the loan can be approved. This is the uppermost thought on consumers' minds and accordingly is the key factor motivating brokers. To be motivated by a higher commission would be a breach of the NCCP Act requirement to ensure there is no disadvantage to clients as the result of any conflicts of interest they may have.

It should not be forgotten that brokers did not achieve 50% of the market by being unscrupulous, unethical, unprofessional or incompetent. Consumers have a choice to go to a broker or go directly to a lender and one in every two choose to deal with a broker.

There is a very good reason why, as CCLSWA quote in their submission, that only 9% of total complaints to EDR scheme COSL are about brokers. This is even more telling considering that brokers comprise the largest group of COSL members. Clearly consumers are happy with the services provided, and standards upheld, by brokers.

Summation

- **MFAA members are not covered by the Terms of Reference of this Inquiry**
- **However MFAA has long been a supporter of high professional, ethical and education standards as long as they are relevant to the industry and the degree of consumer risk and protection required.**
