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Head of Secretariat
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The Treasury
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Dear Sir or Madam

MFAA Response to the Treasury on the Transition to the Australian Financial Complaints Authority

On behalf of the Mortgage & Finance Association of Australia (MFAA), we welcome the opportunity to respond to the Treasury on the Transition to the Australian Financial Complaints Authority (AFCA).

With over 13,000 members, the MFAA is Australia's leading professional association for mortgage and finance brokers. The aim of the MFAA is to help MFAA members to be recognised as trusted professionals and to be their client's first choice. To achieve this aim, the MFAA promotes and advances the broker proposition to consumers as well as external stakeholders including governments and regulators, and continues to demonstrate the commitment of MFAA professionals to the maintenance of the highest standards of education and development.

The mortgage and finance broking industry is relatively new in Australia but continues to demonstrate growth. Mortgage and finance brokers have filled a clear gap in the market, being viewed as providers of comprehensive, and convenient credit advice to clients. Usually representing a panel of lenders, they offer customers a range of products and tailor mortgages to specific needs. Generally, these factors have contributed to demand growth in the industry.

Mortgage and finance brokers provide a distribution network right across the country, often in areas where there are no bank branches. As mainly small businesses or sole operators, each mortgage and finance broker accesses on average 1,000 customers per year, and it is conservatively estimated that the industry as a whole directly engages with over 1.9 million customers every year. Mortgage and finance brokers are strong drivers of competition in the mortgage lending market, providing many small lenders and originators with a 'shop front' to compete against the larger bank branch networks.

It is estimated that around 17,000 mortgage and finance brokers operate in Australia.¹ In September 2017, *Comparator Business Benchmarking* found that local brokers' market share then stood at 55.7 per cent for home loans written compared with 70 per cent for the UK (in 2016)², 27 per cent for Canada, less than 40 per cent in the US and 25 per cent in New Zealand. Industry participants³ agree that within five years, brokers will account for 60 per cent market share in Australia based on prevailing growth trends.

MFAA Commentary on the EDR reform process

The MFAA has made a number of previous submissions to Federal Government and the Parliament, including to the previous Review into External Dispute Resolution and Complaints Framework (Ramsay Review) on the issue of establishing a single scheme environment for EDR. The MFAA has been highly sceptical from the start of this review process, some eighteen months ago, about the merits of establishing a single EDR scheme. We strongly believe that the case for change was not made by the Ramsay Review, and that the suggested benefits of a single scheme do not outweigh the risks associated with such a move.

That said, should the Parliament pass the AFCA Bill, the MFAA is keen to work with the Government to try and ensure that the benefits provided by a multi-scheme environment are not lost through the mandating of a single scheme. The MFAA welcomes this opportunity to engage with the transition team established by the Treasury, and will continue to engage in good faith to ensure that the rights of our more than 13,000 members are protected under the proposed AFCA regime.

Transition to AFCA

The MFAA has three main concerns with a single scheme environment for EDR, which if adequately addressed should hopefully benefit consumers and small financial service providers (FSP). The first concern relates to ensuring that AFCA does not become big bank centric, and is structured in a way that has regard to the needs of smaller FSPs and their consumers. The second concern relates to ensuring ongoing innovation in the handling of small FSP complaints, both in terms of type and nature of complaints dealt with by AFCA, as well as processes and cost. The third concern relates to the proposal to remove the obligation for credit representatives to be members of an EDR scheme, and focuses on ensuring that this results in genuine savings for the industry, rather than a simple transfer of EDR costs from credit representative to licence holder.

Protecting the rights of small FSPs and their customers in the single scheme environment

The MFAA has previously argued that a monopoly scheme was likely to apply a single 'one size fits all' approach to dispute resolution processes. Mortgage broker complaints will represent only a very small percentage of total complaints dealt with by AFCA, however numerically, mortgage brokers will make up a large percentage of the members of AFCA – even if credit representatives are carved

¹ IBISWorld, *Mortgage Brokers in Australia: Market Research Report*, August 2016, p. 1,
<http://www.ibisworld.com.au/industry/default.aspx?indid=1821>

² IRESS, *Intermediary Mortgage Survey 2016*, p. 7,
https://www.iress.com/files/1214/5995/3077/UK_IRESS_IMS_2016_FINAL.pdf.

³ Ernst & Young, *Observations on the Value of Mortgage Broking*, May 2015, p. 2,
https://www.mfaa.com.au/IndustryInformation/Documents/1527742_MFAA_Broker%2020Study_final_email.pdf#search=observations%20on%20the%20value.

out as proposed. On the other hand, the disputes involving the large banks will no doubt make up the majority of AFCA disputes, and be the driving focus of AFCA.

The MFAA is therefore concerned that under such an approach, processes suitable for dealing with a big bank are likely to be applied to small FSPs including mortgage and finance brokers. Equally, the leadership of the scheme will likely be focused on the needs of the major financial service providers, and the strategic focus of the organisation will be much more closely aligned to the major banks, with the needs of small providers being largely ignored.

Such an outcome could result in the fee structures, standard practices and future innovation being set to accommodate the largest members and, in particular, the resolution of their higher profile disputes. The expertise and leadership inherent in the CIO will be lost, and the needs of mortgage brokers and their customers could be treated as a minor subset of the wider industry.

The MFAA represents over 13,000 brokers, most of whom are small businesses and sole traders, who in turn serve hundreds of thousands of small businesses and consumers. Indeed, in regional areas, brokers are often the only business providing financial services, since the major banks have closed branches in so many country towns.

The needs of mortgage brokers are very different from those of the big banks, and the disputes which arise in the mortgage broker market are different from those of the big banks in both scale, systemic importance and potential customer impact. Adverse findings from AFCA, if its focus is on the big banks, could end a broker's business, and we are concerned that AFCA may not have the expertise to deal with small FSP disputes appropriately.

This could undermine mortgage and finance broker confidence in EDR processes generally, and, more specifically, undermine the effectiveness of the mediation process.

At the very least, the MFAA recommends that an independent division, with board and senior executive level leadership and accountability, be established within AFCA to specifically focus on the complaints relating to small FSPs. We also recommend that this division report regularly to member FSPs on activities, costs and the strategic focus of AFCA.

Innovation in EDR

One of the key reasons the MFAA was concerned with the establishment of a single scheme environment for EDR was the impact this could potentially have on future innovation in dispute resolution - in terms of type and nature of complaints dealt with by AFCA, as well as processes and cost. Previous submissions from the MFAA noted the weight of evidence around the negative impact on pricing and innovation in monopoly environments. The MFAA also has previously claimed that this situation could be exacerbated in the EDR environment as such a monopoly would have a guaranteed market, as financial service and credit service providers would be forced to join AFCA regardless of its conduct or effectiveness.

The MFAA has expressed fears that forcing our members to join a massive, slow, monopolistic bureaucracy – would mean they would have to contribute to a scheme that does little to help them resolve disputes. To address this concern, the MFAA encourages the AFCA transition team to consider the needs of all Australian financial service and credit service providers, in the interests of fostering innovation in dispute resolution and robust financial services and credit services sectors.

To achieve this, the MFAA believes that it is vital to have small FSP representation on the board of AFCA. We also recommend that AFCA report regularly to members and customers on innovation in

the small FSP EDR market, and the measures which have been deployed to increase efficiency, effectiveness, responsiveness and accuracy in dispute resolution.

Removal of the obligation for credit representatives to be members of AFCA

The AFCA Bill proposes to remove the obligation on credit representatives to be members of an EDR scheme, with potential disputes relating to them being handled through their credit licensee. The Government's consultation paper, "Improving dispute resolution in the financial system", of May 2017, makes the following observations on the current and proposed treatment of credit representatives.

48. Under the National Consumer Credit Protection Act 2009, both credit licensees and credit representatives are required to be members of an EDR scheme, even though the licensee is responsible and liable for the conduct of their representatives.

49. This requirement is in contrast to the financial services licensing regime where only the licensee is required to be a member of an EDR scheme. The rationale for the financial services approach is that making financial services licensees responsible for the conduct of their representatives, combined with compulsory EDR membership for licensees provides adequate consumer protection.

50. Removing the obligation for credit representatives to be members of an EDR scheme could potentially lower the regulatory burden on industry without impacting on consumer's ability to access redress, as the licensee ultimately retains responsibility for the conduct of their representatives.

The MFAA is in favour of reducing the regulatory burden on credit representatives, however, is concerned that this measure may simply transfer that burden to the credit licence holder. Whilst the obligation to be a member of an EDR scheme may be removed, the activity of credit representatives will still be subject to EDR, with the cost of this activity now being borne by the credit licence holder. In many respects, this may not result in a reduction of the regulatory burden, but rather a transfer of the burden and associated costs.

Equally, the AFCA will need to recover the shortfall in membership fees from the removal of a substantial number of credit representative members, or face a significant funding gap, and a resultant reduction in services. This shortfall will most likely need to be recovered through an increase in the membership cost to credit licence holders, or through the application of complaint fees for consumers. In any case, it is likely that these cost imposts will then be passed from credit licence holder to credit representative, significantly negating the benefit of the removal of the EDR membership requirement.

The MFAA recommends that AFCA be required to specifically measure and report on the cost savings derived from the removal of the requirement of credit representatives to be members of AFCA if this occurs. Equally, the MFAA recommends that all such cost savings be passed directly to the mortgage broking industry through a specific reduction in mortgage broker EDR fees, rather than to all AFCA members.

Recommendations

The MFAA recommends that, in order to protect the interests of small FSPs, improve customer outcomes, and ensure mortgage and finance broker confidence in EDR processes, that:

1. an independent division, with board and senior executive level leadership and accountability, be established within AFCA to specifically focus on the complaints relating to small FSPs;
2. AFCA report regularly to member FSPs on activities, costs and the strategic focus of AFCA;
3. small FSPs be represented through specific representation on the board of AFCA;
4. AFCA report regularly to members and customers on innovation in the small FSP EDR market, and the measures which have been deployed to increase efficiency, effectiveness, responsiveness and accuracy in dispute resolution;
5. AFCA be required to specifically measure and report on the cost savings derived from the removal of the requirement of credit representatives to be members of AFCA if this occurs; and
6. all cost savings from the removal of the requirement of credit representatives to be members of AFCA be passed directly to the mortgage broking industry through a specific reduction in mortgage broker membership fees, rather than to all AFCA members.

Conclusion

As we previously mentioned, the MFAA continues to remain willing to work with the Government to try and ensure that the benefits provided by a multi-scheme environment are not lost through the creation of AFCA. The MFAA believes that should the Government adopt the recommendations in this submission, AFCA will be a much more efficient and effective dispute resolution body and could lead to an improvement in customer outcomes.

The MFAA would like to thank you again for the opportunity to respond to the Treasury on the Transition to the Australian Financial Complaints Authority, and should the Treasury have any questions regarding this submission, please do not hesitate to contact me.

Yours sincerely



Mike Felton
CEO