MONEYQUEST
FINANCE SPECIALISTS

5th March 2018

**Submission to the Productivity Commission**
**Draft Report - Competition in the Australian Financial System, January 2018**

MoneyQuest thanks the Productivity Commission ('Commission') for the opportunity to submit this response via https://www.pc.gov.au/inquiries/current/financial-system/make-submission.

In so doing, we have limited our response to the specific references made by the Commission to mortgage brokers in the Overview and Draft Recommendations report.

That said, we would like it noted, that we support any regulatory changes that promote a more competitive and transparent housing loan market where consumers have even better access and choice.
Before turning to the draft report, we would like to address a couple of comments made by the Presiding Commissioner since the report was released:

- Speaking at a Committee for the Economic Development of Australia on 25th February, it was inferred that the $2.4bn allegedly now paid to mortgage brokers each year of itself warrants a public analysis given 'it is so large'. To this end, we would like the Commission to please consider there are presently c.16,000 mortgage brokers and this top line revenue number represents an average annual revenue per mortgage broker of $150,000. While this number may appear high, we would ask the Commission to consider that this number is before normal business operating costs – including administration staff, occupancy costs, compliance costs, training costs, marketing, IT and so on.

  In short, please do not confuse commission revenue with net earnings.

- Speaking at the same event on the subject of the quantum of commissions paid, a comment was made 'that it is only a customer or a shareholder who could be paying this charge'. Our hope is that the Commission recognises that commissions paid to mortgage brokers simply represents for lenders an outsourced/variable cost. It is not a double-up or additional cost upon the lender or its shareholders. Simply put, if there were no mortgage brokers and the lenders had written these loans, then the lenders would have incurred the same sort of origination costs. The question is more one of - can lenders write the same volume of loans themselves for less than $2.4bn pa, considering the heavy fixed costs needed to be absorbed?

Turning now to the draft report, we would like to raise comment on the following items in the hope of providing better clarification:

- Page 2 – '***customer loyalty is often unrewarded with existing customers kept on high margin products that boost institution profits. For this to persist, channels for provision of information and advice (such as mortgage brokers) must be failing.***'

  The assumption here is incorrect. Mortgage brokers *are not* encouraged *nor* incentivised in any way to offer high margin products to our clients. In fact, we operate to the contrary by considering lower priced products in the first instance. Additionally, mortgage brokers will always look to negotiate the maximum discount we can achieve from a variable rate product to enhance the outcome for our clients. Again, we are not incentivised nor penalised based on the product or pricing of the loan we offer and as such the inference here is incorrect.

- Page 2 – '***the growth of mortgage brokers does not appear to have increased price competition***'.

  Since the evolution of mortgage brokers in the 1990's, consumers have been the beneficiaries of increased competition for their business like never before. This competition is alive and well today with record low interest rates. Mortgage brokers continue to offer a proposition – which includes seeking out a competitive interest rate – that no single lender is capable of offering. This encapsulates why consumers are increasingly turning to mortgage brokers rather than put blind faith in the hope their own bank is offering a competitive proposition at that time they apply. In other words – why take the chance when a mortgage broker can scan what is still a competitive marketplace.

  Furthermore, on 16th March 2017, ASIC released Report 516 and within it concluded that 'Brokers have the potential to exert downward pressure on home loan pricing by forcing lenders to compete'. We would ask the Commission to consider simultaneously the subject of whether mortgage brokers have or have not increased price competition by also considering - what may be the consequence on price competition in a market void of a strong mortgage broker presence?

- Page 2 – '***non-transparent fees and trailing commissions are inherent***'.

  It would appear the Commission has been poorly advised on this subject.
  Mortgage Brokers have a statutory obligation to disclose - amongst other things -how they are remunerated for the services they provide.
  To assist the Commission, we have attached our:

  - *Credit Guide* which is issued to our customers at first contact and prior to us providing any credit advice or assistance;

  - *Credit Proposal Disclosure* document which is issued to our customers - after conducting a *Client Needs Analysis* and *Preliminary Assessment* - in order for them to authorise us to submit their loan application.

  We are reasonably certain both documents would be strikingly similar to those used by our industry peers. We would hope the Commission recognises that the level of disclosure and transparency is not as per their finding and in the writers 17 years working within the mortgage broking industry not a single customer complaint about remuneration disclosures in particular can be recalled.

- Page 5 – ***'Fintechs represent a group that could fundamentally change the nature of competition in the banking system'.***

  While much is being mooted about the rising prevalence of Fintechs, we are yet to see any evidence they can deliver improved consumer outcomes or increase price competition. Until such time as Fintechs can secure funding capability, they will continue to represent yet another distribution channel for existing lenders.

- Page 7 – ***Mortgage brokers do not consistently get lower home loan interest rates for consumers than would be available to the consumer by going directly to the provider.***

  It is very important the Commission understand the relationship between lender and mortgage broker. Mortgage brokers are a third-party distribution channel for lenders and have no discretion pertaining to credit approval or mortgage pricing. Such discretion solely rests with the lender and as such we wish to highlight to the Commission that this statement lacks any relevance.

  That said, there is certainly dynamic pricing discrepancy between lenders and it is this variable that mortgage brokers provide assistance to customers in comparing and identifying the right options.

- Page 30 – ***'Commission payments made by lenders to aggregators and brokers are high'.***

  We refute this statement as simply untrue and without basis or foundation. Should the commission conduct a forensic review into the net earnings of individual mortgage broking businesses, it would find the overwhelming majority are on acceptable average incomes. To this end, MoneyQuest would welcome such a review to once and for all, put a stop to irrational conclusions that have been going on for far too long when simply looking at revenues and not net incomes

- Page 33 – ***Draft Finding 4.1 A Consolidation in Banking***

  MoneyQuest shares the Commission's observation here and points out the correlation that has existed since the issue of new banking licenses in the 1980's – new entrants have a history of delivering exciting new product innovation. In recent times there has not been a lot of innovation in the mortgage space.

- Page 35 – ***Draft Finding 6.1 Cost of APRA Interventions on Home Loans***

  We concur and attach two recent publications we have issued on the subject.

- Page 35 – ***Draft Finding 8.1 – Interest Rates from Brokers v Other Channels***
  ***'Home loans originated by mortgage brokers have only slightly lower interest rates than those originated through direct channels'.***

  We ask the Commission not to see this in a negative light, but rather take comfort that in a very low interest rate environment, mortgage brokers are able to negotiate slightly lower rates than the lenders are offering to customers in their first party branch networks.

- Page 36 – ***Information Request 8.2 Should consumers pay brokers fee for service?***
  ***Should consumers pay mortgage brokers directly through fees for service (rather than brokers receiving commissions from lenders)?***

We would strongly ask the Commission *not* to pursue this line of thinking as to do so would disadvantage consumers who presently enjoy a pricing parity across both the first and third-party channels of the banks and non-bank lenders.

The Commission needs to ask itself - how levying a fee to access a mortgage broker can be in the consumers best interests? Additionally, should such a fee reduce the usage of mortgage brokers, how could this be good for mortgage market competition?

- Page 36 – ***Draft recommendation 8.2 Mortgage Broker Disclosure Requirements***

  We support the Commissions call for plain English documents and offer my assistance or involvement in any future review.

- Page 44 – ***Draft finding 13.1 Mortgage Broker Commission Structures Weaken Consumer Switching***
  ***The payment of trail commissions creates perverse incentives for mortgage brokers by rewarding them for keeping customers in their existing loan. Broker loyalty appears skewed towards the institution, not the customer, and thus likely discourages refinancing. The inclusion of commission clawbacks in the remuneration structure for mortgage brokers acts as a direct disincentive to consumer switching of home loans.***

  While we can understand how the Commission arrived at this finding, it is important for the Commission to understand that mortgage brokers first and foremost put the interests of our customers before our own. We walk the talk when it comes to aspiring to have customers for life and this means readily offering our customers the opportunity to refinance/switch should a better opportunity arise with a competitor or within the same lender.

  That said, it must be acknowledged that when we refinance/switch a customer during the initial clawback period it is a zero-sum game for us financially. That is, we are clawed back the initial upfront commission received and paid a new upfront commission on the new loan put in place. Trail commissions however present no such disincentive.

  On the subject of trail commissions and refinancing/switching, there are a number of points to be made:

  - Trail commissions are paid to mortgage brokers with an expectation from lenders that mortgage brokers manage their customers throughout the life of loan;
  - Lenders do not have this capacity and trail commission represents our remuneration for doing this work;
  - Mortgage aggregators and franchisors have invested sizeable amounts into their CRM's in order to manage their customers and be their first port of call for any queries or assistance regarding their loan;
  - Almost all mortgage brokers will contact their customers at least annually and offer the opportunity to review the suitability of their housing loan against the customer's personal circumstances and requirements which may have changed;

- Quite often during these reviews, a more competitively priced housing loan can be identified however not proceeded with, unless the monthly savings are sufficient enough to warrant the time, effort and inconvenience to the customer. This willingness or tolerance will be different from customer to customer;
- It needs to be noted – and not underestimated - that refinancing/switching necessitates a full new credit application to be complied and submitted to the new lender. In recent times with the increased focus on verifying monthly living expenses, it is taking much longer to complete a refinance application and some customers are loathe to repeat the process all over again unless the monthly savings are significant.

On the subject of clawbacks:

- The average loan life of a housing loan is c.5 years;
- The average clawback period is 2 years;
- Clawback periods differ from lender to lender, but generally provide for one of following:
  - < 12 months 100%, 13-24 months 50%, or
  - < 12 months 100%, 13-18 months 50%, or
  - < 6 months 100%, 7-12 months 75%, 13-18 months 50%, 19-24 months 25%, or
  - < 18 months monthly pro rata

- Page 45 - ***Information Request 13.3 What red tape barriers to switching persist?***

While we commend the Commission for seeking to remove unnecessary 'red tape' barriers in refinancing/switching, we need to point out that the sole significant obstacle for customers to work through is the need to submit a completely new credit application to the new lender OR existing lender. Both need to undertake a fresh assessment – notwithstanding the loan amount will most often not change and notwithstanding the monthly loan repayments will be lower.

It is this process we must put the customers through, that often sees them say 'no thanks' even though they can access a lower interest rate, a lower monthly repayment and significant savings over the remaining term of the loan.

The one feature in the current process that is at times frustrating in trying to deliver a good customer outcome is that some lenders are far more co-operative when being refinanced than others.

The Commission would do well by consumers to help establish some agreed working timelines that all lenders will commit too – with respect to booking refinance settlements.

In closing, it is important for us that the Commission clearly understands the following:

- Mortgage brokers are **not** credit providers – we are credit advisers and as such, we have no involvement in formulating credit policy nor do we have any credit approval capability;
- Mortgage brokers work solely within the individual credit policy set by our lenders;
- Mortgage brokers have always embraced enhancements to our professional standards;
- Mortgage brokers have long demonstrated a willingness to adopt additional regulatory obligations into our credit advice processes;
- Mortgage brokers continue to provide consumers with a service proposition that no single lender can match and this provides enormous peace of mind for consumers;
- Mortgage brokers offer lenders a variable cost third party distribution channel. Much noise has been made over the past 20 years about the origination cost between channels – but what is conveniently always overlooked is that the comparison is never on a like to like basis as lenders would need to absorb a significant buffer in their fixed costs to originate the same quantum of loans.
- Mortgage brokers are appropriately incentivised with the payment of trail commission to manage their customers throughout the life of their loan;
- Mortgage brokers view trail commission as an obligation to continue to undertake work for their customers – including for example loan variations which do not generate any fees or commissions;
- Mortgage brokers are made up of normal small business people who share a passion for helping to put people into homes and generating wealth through property investment;
- Mortgage brokers work for their customers first and foremost and not the shareholders of our lenders.

Yours faithfully,

Michael Russell
Managing Director