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Productivity Commission
GPO Box 1428
Canberra City ACT 2601

Dear Sir or Madam

MFAA Submission to Productivity Commission Inquiry into Competition in the Australian Financial System

On behalf of the Mortgage & Finance Association of Australia (MFAA), we welcome the opportunity to make a submission to the Productivity Commission's Inquiry into Competition in the Australian Financial System. In addition, we thank the Commission for extending the submission date.

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.

1. Background to the Industry and Current Trends

The mortgage and finance broking industry is relatively new in Australia but continues to demonstrate growth. The industry developed as a result of financial deregulation in the 1980s, prior to which banks and building societies provided the vast majority of residential mortgage lending direct to consumers. During the 1990s and early 2000s, the lending market grew in competitiveness and sophistication, with new non-bank lenders driving competition, reducing rates, and offering an increased range of mortgage products. In response, traditional lenders sought to aggressively reduce cost to income ratios, while facing their own branch closures in this changing climate.

Brokers were able to fill a clear gap in the market, providing comprehensive and convenient credit advice to clients. Usually representing a panel of lenders, they offered customers a range of products and mortgages tailored to specific needs. Such factors have broadly contributed to demand growth in the industry. Additionally, larger lenders entered the broker channel between 2002 and 2009, further driving industry development.

Today, mortgage and finance brokers provide a wide distribution network across the country, often in areas where there are no bank branches. This visibility is, in itself, a positive consumer outcome, as greater distribution enhances customer support and promotes access to financial and credit advice and services, driving competition. 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 by the MFAA that the broking industry, as a whole, directly engages with over 1.9 million customers every year. Brokers have become strong drivers of competition in the mortgage lending market by providing many small lenders and originators with a 'shop front' to compete against the larger bank branch networks. This therefore provides scale and viable channels for other lenders in the market that do not have a branch structure.

It is estimated that around 17,000 mortgage and finance brokers currently operate in Australia.[1] In September 2016, *Comparator Business Benchmarking* found that local brokers' Australian market share then stood at 53.6 per cent for home loans written, compared with 70 per cent for the United Kingdom (in 2016)[2], 27 per cent for Canada, less than 40 per cent in the United States and 25 per cent in New Zealand. Industry participants[3] agree that within five years, brokers will account for 60 per cent market share in Australia based on prevailing growth trends.

The finance broking industry has continued to grow strongly in recent years both in terms of broker numbers and share of market with the share of all residential mortgages originated by brokers increasing from 44% in 2012 to 53.6% in 2017 (an increase of 21.8 percent in 5 years). This progression is accredited to an increase in more complex scenarios and products in the property investment market (such as the proportion of interest-only loans and self-managed superannuation funds), requiring greater credit advice to meet consumer needs. Consumers have increasingly sought a financial professional to assist with the more detailed application processes which have evolved since 2011, whereby brokers have provided a more convenient means to facilitate loans. Further, higher consumer satisfaction levels have contributed to an increased referral rate, thereby increasing the broker market share. This growth is illustrated in Figure 1 below.

[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%20Study_final_email.pdf#search=observations%20on%20the%20value.

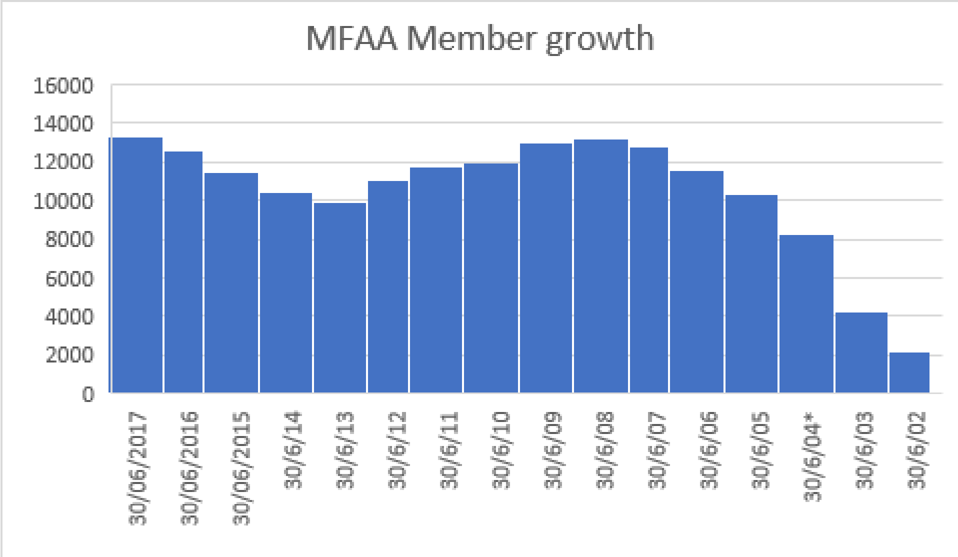

Figure 1: MFAA member growth, 2002-2017

2. Competition in the Australian Financial System Inquiry

The MFAA submits several points in response to each of the Productivity Commission Inquiry's Terms of Reference.

2.1 Contestability and concentration in the financial system

The Productivity Commission Inquiry will examine the level of contestability and concentration in key segments of the financial system, including the degree of vertical and horizontal integration. In considering the impact of vertical integration in the mortgage and finance broking industry specifically, the 2017 Australian Securities & Investments Commission (ASIC) review of mortgage broker remuneration concluded that ownership of aggregator businesses by lenders is a form of vertical integration, whereby lenders control the distribution chain of their products, potentially affecting competition.

To remedy the potential impacts on competition which vertical integration in the mortgage and finance value chain may have, the ASIC review recommended that:

> … participants in the industry more clearly disclose their ownership structures. This proposal is consistent with the findings and recommendation of the Financial System Inquiry to:
>
> > Rename 'general advice' and require advisers and mortgage brokers to disclose ownership structures.
> >
> > (Recommendation 40) (*Financial System Inquiry final report*, p. 271).
>
> We consider that clearer disclosure of ownership structures should extend beyond mortgage brokers and apply to all players in the home loan distribution chain, including lenders, aggregators, and brokers.

> Clearer disclosure should occur in marketing material and at all distribution points (e.g. websites and physical premises).[4]

The MFAA fully supports robust disclosure requirements of ownership structures and broker channels for industry participants and believes that this disclosure needs to target both ownership and influence. As outlined in its response to the ASIC review, the MFAA believes that ownership disclosure should not be mandated for lenders that own up to a 20 per cent stake in a publicly listed aggregator and do not hold a board position, if the lender has no demonstrable influence over the aggregator. This proposed limit would mitigate the risk of ownership disclosure being both misleading to customers and damaging to the aggregator.

Further, the MFAA supports the extension of disclosure requirements to 'white label' products. Whilst anecdotal evidence points to the fact that current disclosure levels for white label products is high, the MFAA believes that this should be made mandatory. By improving disclosure requirements, the industry will further entrench consumer protections and continue to positively impact competition.

2.2 The degree and nature of competition

The Productivity Commission Inquiry will consider the degree and nature of competition as it relates to mortgages, and credit and financial services. As discussed above, changes to the mortgage and finance industry have resulted in significant growth in the number of brokers in Australia, which has in turn supported the proportion of residential mortgage loans facilitated by brokers. MFAA data produced by Comparator (a CoreLogic company) indicates that 53.6 per cent of residential mortgages are written by the broker channel as of March 2017.

The industry facilitates competition by providing a distribution channel for lenders, which enables small and foreign lenders to compete with the major banks despite lacking an equivalent national footprint, or the scope to invest in infrastructure such as bank branches. Overhead savings have the potential to lower customer costs, contributing to lower mortgage pricing. This process consequently applies downward pressure on loan pricing across the board, by forcing lenders to compete for business in this sector.

A competitive market is a prerequisite to consumer satisfaction vis-à-vis pricing, robust service delivery, efficiency, innovation and product diversity. Through increased competition, consumers are presented with a wider range of product features than would otherwise be delivered via traditional lending structures, such as improved interest rates, new product characteristics, and different structures and service levels. It is estimated that large broking groups (including aggregators) can typically offer more than 1,400 products to customers, demonstrating why borrowers increasingly seek advice in order to be better informed and choose an appropriate product. Such a range therefore supports a more informed consumer choice in addition to driving greater competition between lenders.

The industry also delivers greater convenience for consumers via the inherent flexibility offered by brokers, as opposed to traditional branch-based lending, which removes some of the effort and difficulty in accessing financial advice or securing a loan. Importantly, brokers additionally offer expert, tailored advice to customers over a range of increasingly complex products on offer, allowing for a

[4] Australian Securities & Investments Commission (ASIC), *Report 516: Review of mortgage broker remuneration*, March 2017, p. 25.

more refined and personalised product to be matched to different customers with distinct needs. It is clear that, without the services offered through the mortgage and finance broker channel, customers would be obliged to revert to branch-based lending. This would ultimately result in fewer products on offer, less flexibility and a decreased number of lenders, together producing a less competitive climate in which larger bank networks would thrive at the expense of smaller lenders.

2.3 International comparisons

As a result of increased levels of competition and financial deregulation, the Australian credit sector has produced a more diverse range of customer mortgage products. A prime example is found in the growing use of mortgage offset accounts. Such accounts are not widely available in overseas home loan markets, and enable customers to 'offset' the interest they are paying on a home loan against the savings (or increased loan amount) in an offset account, while keeping these savings liquid. This is not only a tax effective savings mechanism, but also, in many instances, contributes to a faster reduction in principal repayments due to interest savings. By assisting customers to minimise the interest payable on a loan, brokers are key facilitators of this innovative product. It is unlikely that such innovation could occur in a less competitive environment, through which customers are granted a higher level of financial flexibility and easily accessible additional loan funds.

Given the geographical nature and population distribution across Australia, Australia's financial system demands greater flexibility in the provision of credit advice and services in comparison to other markets. By providing greater accessibility through a more widely spread national network than traditional branch-based lenders, the mortgage and finance broking industry enhances competition in the domestic market in a way that is unique to Australia.

2.4 Barriers to, and enablers of, innovation and competition

Together with the benefits to competition provided by brokers outlined above, there are significant barriers to entry which brokers are able to minimise for both lenders and customers. For example, the broking industry reduces barriers to entry by providing a distribution network for lenders that do not enjoy a national footprint, such as small lenders, foreign banks and credit unions. Such lenders are therefore able to engage with customers without the need to invest in branches or other physical infrastructure. This has become increasingly important following industry-wide branch closures and rationalisation. Further, the broking industry allows lenders to differentiate their products to capture different segments of the mortgage market, enhancing competition and enabling ongoing innovation in the credit sector.

Wholesale mortgage brokers (or aggregators) are able to reduce barriers to entry by managing a significant volume of brokers on a regular basis, and therefore reduce the financial burden on lenders. Such management might include training, distribution of new or revised product details, compliance monitoring and assessment, and payment of remuneration for settled loans. By reducing lenders' fixed costs, wholesale mortgage brokers enable more competitive loan pricing to a greater degree than would otherwise be possible in a more rigid structure, encouraging competition between lenders.

Customers have also enjoyed reduced barriers to entry to the housing market via the mortgage and finance broking industry. The increase in competition and product innovation observed following deregulation has led to a greater amount of available finance, resulting in smaller deposits required by lenders, and therefore providing solutions for borrowers with an impaired credit history, irregular or lower income. Ultimately, this puts home ownership within the reach of more Australians – an increasingly important consideration in today's housing market.

The MFAA notes that there are certain barriers to entry which are essential to ensure the proper conduct of the mortgage and finance broking sector. For example, all qualified individuals or corporations providing credit advice must either hold an Australian Credit Licence (ACL) or be an Appointed Representative of a licence holder. In addition, most lenders and aggregators require brokers to be a member of either the MFAA, or the Finance Brokers Association of Australia (FBAA) and adhere to the Codes of Conduct and ongoing education and professional development requirements set by these bodies. These licensing and membership obligations require compliance with legislation including the *National Consumer Credit Protection Act 2009* (Cth), as well as privacy and other regulatory obligations and are crucial in maintaining professionalism and ongoing development to ensure positive customer outcomes.

2.5 Development of government policy

With respect to potential policy changes, the MFAA has welcomed the March 2017 ASIC review of mortgage broker remuneration,[5] and the positive impact it will likely have in further improving consumer outcomes, as well as ensuring remuneration structures throughout the mortgage and finance value chain continue to support strong competition in the wider sector. A key consideration of any policy reform, such as those canvassed in the ASIC review, is the likely impact such reforms may have on competition and potential impacts on all consumer outcomes, rather than on only those serviced by brokers.

As articulated in our response to the ASIC review, the MFAA strongly supports industry self-regulation, and believes that this is the best way to achieve genuine change throughout the mortgage and finance value chain, and to enhance consumer outcomes. This aside, the MFAA does not believe in retention of the status quo, and as such considers that self-regulation must have good consumer outcomes and competition at its heart, be fit for purpose, and genuinely tackle areas of conflict of interest in remuneration.

The MFAA has collaborated with the Australian Bankers' Association (ABA) to take a joint leading role in the establishment of an industry-wide working group (the Combined Industry Forum) which encompasses the ABA; the MFAA; the FBAA; the Customer Owned Banking Association (COBA); the Australian Finance Industry Association (AFIA); as well as industry representatives from lending, aggregation and broking businesses across both traditional and non-conventional lenders. As a result, the MFAA strongly believes that the Combined Industry Forum is not simply a product of the major banks, instead representing lenders across the entire industry. This forum will focus on the implementation of effective industry self-regulation, and reflects the MFAA's belief that no part of the mortgage and finance value chain can seek to regulate itself in isolation from the others.

The MFAA has developed the following key principles which it believes should guide future reform. The mortgage and finance industry:

- supports industry self-regulation;
- has better consumer outcomes at the centre of its approach;

[5] Australian Securities & Investments Commission (ASIC), *Report 516: Review of mortgage broker remuneration*.

- is committed to transparency and accurate disclosure;
- will promote competition at all levels of the industry;
- aims not to change the structure of the industry or unfairly disadvantage any part of the value chain;
- will promote simple and achievable solutions; and
- seeks solutions which can be applied to all States and Territories.

These principles are strongly supported by MFAA members, and importantly form the core basis of the guiding principles agreed to by the wider Combined Industry Forum.

3. Summary: Increasing Competition and Access to Credit Services through the Mortgage and Finance Broking Industry

The mortgage and finance broking industry encourages competition with larger lenders in the market and increases access to financial services in a number of ways. For example, brokers offer a wide distribution across metropolitan and regional Australia, connecting a greater number of lenders and customers. The diversified range of products available in the market today was originally driven and greatly facilitated by brokers, in comparison to traditional lending structures in place prior to deregulation. Together with the more flexible, convenient and personalised service offered by brokers, the industry is able to improve competition between larger and smaller lenders and promote better access to services.

3.1 Wide metropolitan and regional distribution

The industry provides a wide distribution network across Australia that includes services in regional and remote areas, in addition to metropolitan cities (illustrated in Figure 2). By extending services to areas otherwise largely devoid of bank branches, brokers are able to reach a greater number of customers and thereby increase access to financial services.

Figure 2: Current mortgage broking industry distribution in Australia

This geographical presence is a key value-add recognised by lenders, reflecting the inherent flexibility of the mortgage broking industry and enhanced customer service on offer. As a result of this distribution, brokers provide greater convenience for customers; a higher degree of independence than traditional lenders; and a more tailored service for each customer. This reflects well on lenders and the mortgage industry as a whole, and customers ultimately receive a higher quality of service and advice. Increased competition is a natural flow-on from this geographical spread, providing a 'shop front' for small lenders, credit unions and foreign lenders to better compete with larger bank networks.

3.2 Increased range of products

Deregulation has led to a substantial increase in the number of mortgage products across the market, with the broking industry providing greater access to new products and offering more specialised advice than was traditionally accessible. This increased range has led to a predicted surge in the complexity of products available due to a more competitive market, highlighting the growth in demand for professional broker support.

Large broking groups (including aggregators) typically offer over 1,400 products to their customers, highlighting why borrowers increasingly seek advice to help choose an appropriate product. The services of mortgage brokers and wholesale mortgage brokers (third party distribution services) are increasingly important in the Australian mortgage landscape. The MFAA notes that third party distribution is an important channel for the major banks, as it has assisted them to maintain and grow their market shares, particularly after the substantial major bank branch closures in the 1990s.

3.3 Enhanced consumer support

The industry provides significant support for borrowers, which increases competition in a number of ways. For example, individual mortgage brokers generally engage with a comprehensive network of lenders to extract competitive loan rates for customers. By reviewing a range of lending sources, assessing loan prices against other options, and ultimately providing a choice of the most viable options for the borrower, mortgage brokers create leverage within the market for originators to provide their most competitive price available. Increased competition is therefore an inherent by-product of this process, whereby lenders are driven to adapt their offered prices and increase their customer appeal.

A related key benefit for borrowers is the single point of contact provided by brokers, which saves time and reduces the administrative burden. Together with a more customised approach to each borrower's needs, this provides a more streamlined and personalised approach, which thereby enhances overall customer satisfaction and reflects well on the mechanics of the industry. Further, the strategic advice provided by mortgage brokers is often essential for customers to navigate an increasingly complex field, and determine which products are most appropriate for their needs.

3.4 Competition

The central outcome of more widespread distribution; an increasingly innovative and complex range of products; and enhanced customer support, is the competition created with the big banks. By facilitating lending from both major banks and smaller lenders, brokers ensure greater choice and drive competition in product features, structures, interest rates and service levels, whilst providing convenience and expert advice to minimise complexity for borrowers.

The MFAA would like to thank you again for the opportunity to respond to the Productivity Commission's Inquiry into Competition in the Australian Financial System, and should the Commission have any questions regarding this submission, please do not hesitate to contact me.

Yours sincerely

CEO