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PRODUCTIVITY COMMISSION INQUIRY INTO COMPETITION IN THE AUSTRALIAN FINANCIAL SYSTEM

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Thank you for the opportunity to make a submission in relation to the above review.

I have been employed in banking and finance since 1970. This experience includes being employed by a major bank over a 27-year period, and being hands on in mortgage broking since 2001.

I am concerned about what is happening to the mortgage broker profession and distorted views being accepted as an accurate portrayal of fact.

A mortgage broker does not sell loans they sell a mortgage broker service.

A mortgage broker service involves researching the market place to find a match between what our client wants to buy from a lender who wants to sell them a loan product. This aspect of the mortgage broker service a borrower can do for themselves.

We then prequalify our client using the bank/s set approval criteria. This aspect of our service the borrower cannot do for themselves.

We then provide our client with options from some banks who want to sell their loan product to our client, and from our experience who is likely to approve their application.

Once our client has decided which bank is their preferred option to buy a loan product from, we smooth the path to funding by assisting our client through the application to settlement process.

As you can see the selling and buying of a loan product is between the bank and the borrower. Our service facilitates the process.

Mortgage broker businesses are independent contractors who most often have a commercial agreement in place with an aggregator.

The payment received from the aggregator is gross business revenue determined by a commercial contract between the two parties. Mortgage brokers do not usually charge their client a fee.

Each aggregator has a set number of banks on their panel of lenders.

The panel of lenders changes from aggregator to aggregator and from time to time, the bigger players appear on all.

Each bank pays the aggregator once they have found new business for them. A “Commission” payment is paid for each new loan the bank successfully sells to an introduced client.

The banks pick and choose which loan applications they accept and refuse. They do not accept all mortgage broker client applications introduced to them, even if the application fits the prequalifying criteria. Credit scoring has been used to refuse some creditworthy applicants who prequalified for approval.

Sometimes a mortgage broker client refuses the loan offer received from a bank the mortgage broker submitted their loan application to. The aggregator and mortgage broker receive no remuneration in these situations.

The commission payment is gross business turnover that expenses are accounted for before any profit or wage can be determined. There are two main components of the aggregator payment a mortgage broker may receive part of for the introduction of new loan business, an upfront and a trail.

The upfront payment is the larger portion, an aggregator receives around 0.6% of the amount borrowed and a small trailing commission of around 0.15% of the outstanding loan balance (less any offset or redraw balance). This amount is paid monthly provided the loan stays in order.

Both these payments are paid by the bank to the aggregator for the introduction of new lending business. The mortgage broker receives a share determined by the commercial agreement they have with their aggregator.

After funding of the loan, the mortgage broker retains their client for future mortgage broker service requirements, and the bank acquires ongoing loan account service and maintenance responsibilities. The bank has opportunity to sell other banking products to the introduced customer as it sees fit.

Chanel conflict between the bank and the mortgage broker occurs when bank staff offer other loan products to the mortgage broker client or switches the loan account into the bank initiated book. When this occurs, the bank may clawback the upfront commission paid, and stops the trail payment to the aggregator, even if the loan amount remains the same.

Mortgage brokers are not paid by banks. They are paid by the aggregator to help them find new loan customers for the banks they have a commercial arrangement with.

Mortgage brokers have no legal claim on any moneys paid by any bank to any aggregator. They are reliant on the aggregator staying solvent and honouring the agreement between them to receive any payment due. If they leave the aggregator or produce low volumes of business their commercial agreement can be terminated and any ongoing “trail payment” is usually kept by the aggregator.

The original concept of aggregation was all the aggregator’s mortgage broker clients’ new business would be added together to aggregate a total that is attractive to each bank on their panel. When the volume of new business reached certain amounts, the aggregator received additional bonus remuneration. This type of bonus remuneration has not traditionally been shared with mortgage brokers.

There is a current push for the aggregator model to be seen differently from what it was set up to do. The term “Broker Group” has been introduced. Producing a very different connotation to aggregation. It suggests the broker group is one competitive body competing against other broker groups. Aggregator Whitelabel (bank funded) products are being promoted as the new channel conflict free distribution solution for brokers. Only available from “Broker Group A” nowhere else. So “Broker Group A” competes with “Broker Group B” and both these compete against the proprietary channel of the bank who is funding all the loans under the different names.

Each broker group has its own commercial agreement with the same Whitelabel funder as the next broker group. So, a web of competition illusion is being created.

The original concept of aggregation was for one business to gather many competing small enterprises results to obtain a better outcome for all the businesses involved. "Broker Groups" are designed to create a distribution channel of the aggregators own brands of loans to be positioned as priority products over other channels.

The mortgage broker proposition is being changed from that of a mortgage broker service to a broker group Whitelabel sales force.

Originally the mortgage broker and the bank had little interaction.

The aggregator sat in the middle and the banks knew little of what business a mortgage broker introduced to their competitors. Over time the banks started to ask aggregators who were their higher-volume mortgage broker introducers as the banks wanted to hone in on them to entice the mortgage broker to send more business there way.

In the early 2000's remuneration payments were larger than they are now. The mortgage broker introduced new business details to the aggregator via lodgement notification and submitted the client's application, identification, and supporting documents directly to the lender via facsimile transmission, post, or by hand. The bank's lending operations departments looked after everything from data entry, valuation ordering, credit assessment, loan documentation, returned documentation checking, and settlement etc.

Today, via the aggregators gateway to the banks online systems, the mortgage broker is expected to complete the application data entry, scan and upload supporting documentation, order valuations, check for errors and print off loan documentation, follow up loan documentation, make sure the certification for settlement occurs and that settlement is booked.

The functions of the bank lending operations departments have over time been transferred to the mortgage broker. This has increased the workload on, and the cost of operations to the mortgage broker for less remuneration than they received a decade ago.

The bank initiated self-regulatory industry forum has suggested that more back-office responsibilities, even loan monitoring, need to be transferred to the mortgage broker, remuneration needs to be reduced and the banks will complete customer outcome scorecards on brokers to assess if they can operate in the industry.

Before a mortgage broker can introduce new business to a bank on their aggregators panel they must obtain an accreditation issued by each specific bank.

There is no legal requirement for an Australian Credit Licence holder to be a member of an industry body.

A mandatory accreditation requirement that has crept in (for new or to transfer accreditations) forces the mortgage broker to be a member of one of two industry bodies. Either the Mortgage and Finance Association of Australia (MFAA) or Finance Brokers Association of Australia (FBAA).

The forced mortgage broker membership model creates a conflict of interest for these industry bodies in being able to honestly represent the mortgage broker position at any mortgage industry forum. Neither body can represent both the mortgage broker and the banks' interests at the same time.

The banks and the sanctioned industry bodies are very aware that in the current environment mortgage brokers have no negotiation right in the commercial contract between the banks and the aggregators – some are bank owned aggregators so effectively they negotiate the commercial contract with themselves. That in turn effects the gross business turnover of associated independent contractors.

The bank controlled accreditation system allows individual mortgage brokers to introduce new loan applications to the aggregator and gives the mortgage broker access to the banks systems to source information and upload / send the associated loan paperwork directly to the bank.

The mortgage broker has no commercial or employment remuneration agreement in place with the bank. The bank determines the criteria for accreditation and has the sole discretion to grant, refuse, or cancel an accreditation. Without bank accreditations mortgage brokers cannot offer a mortgage broker service to consumers even if they hold a credit licence.

The accreditation system has been crossed with the aggregator model and evolved into an unpaid quasi-employment arrangement. To hold an accreditation a mortgage broker is assessed by the bank and given implicit instructions that cannot be deviated from during the loan application process through to funding of the clients' loan.

As the aggregator is remunerated for the introduction of new business by the banks, and the mortgage broker has no industry body or fair work representation they must submit to the banks ever increasing unpaid workload demands on them or exit the industry.

Around 2007, with Westpac being the first mover, aggregator upfront and trail payments were slashed by more than 30%. Then games started to be played via breaking the upfront into portions of "bonus criteria", such as, .05 for lodging online and .10 submission quality etc. The combined amount paid was less than pre-2007 amounts.

The banks also increased clawback of remuneration period up to some astounding 24 months.

Clawback of remuneration paid is an immoral and unethical transfer of commercial risk from the bank to the aggregator, knowing the mortgage broker, who they have no contract with, will bear most of the monetary loss.

Regulators are too close to the hierarchy of the banking sector, which includes the bank accreditation reliant industry bodies, to have an unobstructed vision of grassroots competition in mortgage broking. Their focus is on the big picture of the system and not on the effect on individual situations being played out repeatedly across the industry.

An explosion with much consumer hurt usually occurs before the regulator steps in and the real problems are acknowledged. (Peer-to-Peer lending has red flags).

The truth is, via many years of manipulation by the major banks, the mortgage broker profession is losing its ability to be an effective competition tool and the regulators are interfering with consumer rights of being able to make financial decisions that fit with their requirements and objectives during various life stages. Responsible borrowing and reasonable inquiry are foreign language and all borrowers are considered to be liars or simply incapable of managing their own financial affairs.

The ignorance of how money and banking interact is causing systemic regulatory problems for consumers. The RBA has lost control of monetary policy and the talk of the cash rate having "an influence" on their mortgage and deposits rates is misleading and deceptive.

The cash rate is 1.5%. Major banks for owner occupied, principal and interest repayment, standard variable loans, interest rates are around 5.20% p.a. With line of credit owner occupied loans, the interest rate ranges from 6.37 to 6.44% p.a.

These two loan types a few years ago were the same or slightly different. Now because of the regulatory impact consumers of line of credit products are paying up to 1.24% p.a. more into bank coffers because the regulator has decided the product they have is no good for them.

Consumers are being penalised because of the loan repayment or loan product preference they have. Even if the loan has been in existence for 10 years when the two types of loans had the same interest rate.

In dollar terms the additional interest cost on a $350,000- loan balance at 1.24% for one year is $4,340- and on a $500,000- it equals $6,200-. How has this been allowed to occur in a “consumer protection” regulatory landscape?

The consumer could have paid the additional interest amounts off their loan to produce a smaller debt and greater equity, instead the regulatory interference has increased the banks profit margin at the consumers expense.

The bank says rate for risk – a total mistruth. In the circumstance of high loan to value ratio or low deposit loans, we see a premium interest rate for risk being applied. Yet these borrowers pay many thousands of dollars for the lenders mortgage insurance premium, which protects the lender against loss due to borrower repayment default.

For many Australians with bank mortgages, interest rates are not at an all-time low and unlike the cash rate have been increasing consistently for quite some time.

We have gone from banks issuing a one-page product interest rate sheet to 4 pages.

Positive credit reporting has poor consumer outcomes as it allows banks to easily discriminate against responsible credit worthy consumers and encourages forensic rather than reasonable inquiry into a consumer’s financial position.

ASIC’s obsession with years to retirement, forensic living expense calculations, and interest rate buffers is also discriminating against responsible credit worthy borrowers. They are overstepping their responsibility as a regulatory body and are inexperienced in banking.

The people for whom laws are meant to protect are the losers with APRA having a conflict of interest between having “unquestionably, strong, big banks” and being funded by the industry they are the regulator of.

ASIC is not free of conflict of interest either because they also are funded by the industry they regulate. The big players are the big payers.

Both these regulators should be independent and funded by the taxpayer as they are charged with protecting the Australian banking system, depositors, businesses, consumers, investors and creditors.

These regulators are interfering in matters that are not their area of expertise and the unintended consequence is hurt borrowers and unempowered consumers and businesses.

ASIC role is not to assess remuneration between commercial entities, rather with the NCCP it is limited to ensuring certain gross business turnover payments are disclosed to consumers via a legislated paper trail. In the case of the mortgage broker the amount of remuneration received is unascertainable for up to two years due to bank clawback provisions.

Report 516 was a costly taxpayer exercise that does not have any measure of quality consumer outcome but does have an agenda of allowing the big banks to act as unsavoury Corporations. Especially as the report's findings were based on "**potential**" impact of behaviour, not actual evidence of bad behaviour or poor consumer outcomes.

In the early 2000's a mortgage broker could, and did, make providers of mortgage loans accountable for shoddy service, policy discrimination, product inadequacy, and product price. Not today as the banks "own" the aggregators and rule over the mortgage industry bodies.

There is currently a 'Big Bank' led self-regulation move over the mortgage broker industry in an attempt to breach employment and competition laws through devious ways. Even consumer group have been invited to join the forum decide how and under what conditions mortgage brokers are commercially remunerated.

The Stephen Sedgwick Australian Bankers Association paid for report, the ASIC proposals stemming from the review on mortgage broker remuneration, and bank led mortgage industry self-regulation forums.

> *"The banking industry has committed to implementing the recommendations of the 'Sedgwick Review', covering changes to remuneration and incentives for bank employees, governance and performance management systems, and payments to third parties, including mortgage brokers." ABA sub11, pg.4*

The manipulation is designed to create a lower commercial remuneration structure, increase the workload, and to introduce employment connotations on independent contractors who are already regulated by ASIC under the *National Consumer Credit Protection Act, 2009.* The mortgage broker has no industry body representing it in the self-regulatory forums.

Vertical integration in the mortgage lending space, combined with horizontal integration by the continual buying out of the competitor to ensure market dominance, has perverted the distribution chain.

The original mortgage broker model of the early 2000's no longer exists. It needs to be resurrected to ensure the viability of competition and consumer protection.

The two industry bodies the MFAA and the FBAA cannot genuinely represent the independent mortgage broker as they are both reliant on banks insisting on mandatory membership of one of these two associations to hold a bank accreditation.

Without holding a bank accreditation, a mortgage broker is banned from introducing any new business to that bank. If a consumer wants to use a bank that the broker has been refused accreditation from, because they are not a member of one of these industry bodies, the consumer must find a mortgage broker that does hold an accreditation or they must go directly to the lender themselves.

Mortgage brokers do not sell home loans, they do not have loan products, they do not approve loans and they do not accept any loan offers.

Mortgage Brokers sell a mortgage broker service.

Mortgage managers are not mortgage brokers. They have distinctly separate roles. While a mortgage manager may have the ability to set a borrower's interest rate a mortgage broker does not. The mortgage manager has mortgage loan contracts and loan accounts that they manage after the loan is funded. Mortgage brokers do not have mortgage loan contracts with consumers or loan accounts or have a loan management role after funding settlement.

Mortgage management is not as common as it was before the banning of deferred establishment fees and due to the crash of the RMBS market, commercial remuneration agreements, and responsible lending obligation under the NCCP. The banks could no longer delegate their approval authority.

With the popularity of mortgage management decreasing Whitelabel products are being introduced to replace them. These products represent wholesale funding of banks being labelled as another brand.

Whitelabel products conflict with a competitive market place. As does major banks owning multiple brands of banks and aggregators and mortgage brokers. The consumer is confronted with an illusion of competition. The tactic is deliberately designed to make it appear that there is more competition than is true.

In recent years we have witnessed the introduction of bank selected mortgage broker clubs. This sale centric bank initiated game play is designed to segregate the mortgage broker from the aggregator. The bank calls the mortgage broker their business partner to confuse who the mortgage broker is engaged and paid by. It is designed to punish any mortgage broker who does not provide these banks with big volumes of business. By giving priority service to the broker club member clients the banks are treating other consumers less favourably. Consumers they offer a payment for the aggregator to find. Client centric mortgage brokers are not likely to recommend a bank who provides such poor service performance to their client unless there are no alternatives. It’s just bad business practice that need to be called for what it is. A breach of the general conduct obligations of the NCCP, in dealing with consumers efficiently, honestly, and fairly.

To finish, I believe that any bank owning an aggregator is extremely detrimental to competition from end to end of the industry.

The bank owned aggregator has access to all product, policy, and price information for every one of their competitors on their bank panel. They have data on what customer profiles are attracted to each one of their competitors on their bank panel. They have data on which mortgage broker introduces what type and dollar value of new business to each one of their bank competitors. They have data on turnaround times, service levels, and access to their competitors’ business development managers. The have data on remuneration paid by their competitors and data on how much various mortgage brokers are paid. Etcetera, excetera, excetera.

In good faith,

Maria Rigoni

Mortgage Broker.