Suite 104, 3 Rider Boulevard, Rhodes NSW
2138 **p:** (02) 9194 1703 | **f:** (02) 9475 4466
w: www.homeloanexperts.com.au

26 October 2018

SUBMISSION: Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry – Interim Report

To the Commission,

Home Loan Experts is a specialist mortgage broker focused on assisting good borrowers who are not well-serviced by our industry. Typically, this is because their situation is complex and requires more expertise or because the major lenders don't work with that type of customer.

Being a specialist mortgage broker, we deal with a wider range of lenders than other brokers. As such, we're required to keep our finger on the pulse when it comes to changes in our industry and the impact that these changes will have on our customers.

Our submission has been written with input from customer-facing staff to give the Commission a different point of view when compared to other submissions.

Where we can see that others in our industry have covered an issue well, we've kept our submission brief or added additional examples to assist the Commission.

Reasonable inquiries and living expenses

The interpretation of the *National Consumer Credit Protection Act 2001* (NCCP Act) has progressively changed since its introduction.

One area of interest for the Royal Commission was the living expenses of customers and if these were discussed and verified or if a benchmark was used.

We believe there are several lessons for our industry, the government and regulators regarding living expenses and how we could have done this better.

The Commission focused on whether the law was followed or not and it appears in some cases it was not.

However, we believe the discussion needs to be expanded to *why* it was not followed and whether the law needs to be clarified or changed.

Effectiveness
We need to question whether the current method of investigating living expenses creates a better outcome for customers.

Our mortgage brokers are specialists in lending to Australian expats, people with unusual employment situations, doctors, the self-employed, property investors, first home buyers and many other good people who are unable to get the finance they need.

Suite 104, 3 Rider Boulevard, Rhodes NSW
2138 **p:** (02) 9194 1703 | **f:** (02) 9475 4466
w: www.homeloanexperts.com.au

Our experience has generally been that it is a poor experience for customers and many of them consider it to be an invasion of privacy.

The flow-on effect is that changing lenders becomes too difficult and borrowers become complacent and simply accept higher interest rates or onerous fees. This is certainly not in the best interest of customers.

Obviously, where a customer is spending significantly more than is reasonable on their living expenses, a frank discussion is very important to ensure that they either reduce their expenses or reduce their loan amount.

We, as an industry, need to fix this pain point for customers while also ensuring that we have a meaningful discussion with people that are living outside of their means.

The current laws are simply not effective at achieving this customer outcome and we believe they should be reviewed after extensive consultation with stakeholders.

We cannot at this time give a definite solution for this problem, rather we believe the correct outcome of the Royal Commission should be to identify that this problem exists and that further work is required in this area.

Complexity vs risk
The process of making inquiries into and then verifying living expenses is very complicated and time-consuming, so the question is whether this is "reasonable" for all clients and transaction types.

The banks have confirmed in their submissions that confirming living expenses has become "too hard" and there is truth to this that requires further investigation.

Potentially there is a better way to do this.

For example, we can see that clients with significant credit card debt are far more likely to have living expenses well above the Household Expenditure Method (HEM) benchmark.

Potentially, we use this latest living expense measurement method for high risk clients and use a simplified method for lower risk clients.

We do not have the answers for this but we believe a better outcome for borrowers and lenders will be achieved if this requirement to confirm living expenses is questioned.

Clarity
It is not enough to tell my broker team what they must not do. I must also tell them what they should do instead.

Suite 104, 3 Rider Boulevard, Rhodes NSW
2138 **p:** (02) 9194 1703 | **f:** (02) 9475 4466
w: www.homeloanexperts.com.au

There is a lesson here for our regulator.

The regulatory guides created by ASIC have been very helpful for our industry and I believe we need more guides like this as well as the ability to more easily engage the regulator with questions.

When we've contacted ASIC in the past seeking clarification, we have been told to read the NCCP Act, read the regulatory guides or seek legal advice, yet, if we interpret the law incorrectly, we risk being punished.

With this latest method of measuring living expenses, there are many questions which remain unanswered.

For example, let's say a customer has living expenses of $5,000 per month yet their home loan only services if their living expenses are $4,500 a month:

> What are "reasonable" inquiries we need to make and evidence that we need to provide to show that the client is able to reduce their expenses in order to afford the home loan?
> Is a letter from the client confirming that they are committing to reduce their expenses sufficient?
> Should we wait three months and ask for new bank statements?

Where we can reach agreement with ASIC about what is expected and have this included in a regulatory guide with clear examples then this will ensure a uniform standard of compliance that meets community expectations and protects borrowers.

Specifically, an expansion of *Regulatory Guide 209* would be beneficial to give our industry clarity not only on making reasonable inquiries into living expenses but other areas such as best practice for a preliminary assessment and determining a responsible approach to a borrower that's reaching retirement age.

The role of intermediaries and remuneration

We agree with the Commission that there is a gap in the understanding of the role of intermediaries.

However, this idea that there is systematic misconduct in the mortgage broking space is unfounded.

We have long and wholeheartedly agreed with a 'customer first duty' or 'best interest duty' bolstered by fair compliance and regulations that don't unnecessarily hinder mortgage broking professionals.

Our mortgage brokers are specialists in lending to Australian expats, people with unusual employment situations, doctors, the self-employed, property investors, first home buyers and many other good people who are unable to get the finance they need.

Suite 104, 3 Rider Boulevard, Rhodes NSW
2138 **p:** (02) 9194 1703 | **f:** (02) 9475 4466
w: www.homeloanexperts.com.au

The Combined Industry Forum (CIF) and other industry bodies is investigating right now the most appropriate framework for a duty or code of conduct.

We believe this is a complex issue that requires the input of many stakeholders and has a high risk of creating new problems.

As such, it is best to commence the debate via the Royal Commission but, ultimately, resolve it between ASIC and the CIF.

Remuneration of mortgage brokers is a complex issue and we disagree with the Royal Commission's findings that volume based commissions lead to poor customer outcomes.

We note that the RC has found that broker introduced loans have higher Loan to Value Ratios (LVRs), debt to income ratios and higher arrears.

We also note that the RC has used data that otherwise accounts for the types of borrowers that use a broker vs a bank directly.

However, we believe that this data is misleading as it doesn't consider that many borrowers approach a broker after a bank has been unable to meet their needs. In our experience, this is the most common reason for customers to approach a mortgage broker.

For example, a borrower may require a loan at 85% LVR to settle on purchase they have made at an auction but their bank will only lend them 80%.

They then approach a broker who identifies that their bank only lends 80% LVR in that location and so submits to another lender that will consider higher LVRs for regional areas.

In this example, the borrower has received a better outcome via a mortgage broker and yet the data would indicate that the broker has intentionally geared the customer to a higher level than their bank would have for the purposes earning a higher upfront and trail commission. The client would have a worse debt to income ratio as they have borrowed more.

The data simply doesn't tell the entire story:

A very high proportion of home loans via mortgage brokers are for customers seeking a loan from another lender because the original lender hasn't met their needs.

The Value of Mortgage Broking report (July 2018) by Deloitte Access Economics clearly shows that the majority borrowers (9 out of 10) are satisfied with their experience with brokers. Around a quarter of respondents were first home buyers.

We put forward that the reasons for using a mortgage broker are different to the reasons for using a bank directly and the data that suggests brokers are intentionally putting clients in a highly-leverage position needs to be viewed in that context.

Suite 104, 3 Rider Boulevard, Rhodes NSW
2138 **p:** (02) 9194 1703 | **f:** (02) 9475 4466
w: www.homeloanexperts.com.au

Borrowers tend to be getting a home loan that better suits their needs via a mortgage broker whereas directly via a lender they may be limited by that lender's products or conservative risk appetite.

There is, of course, always the potential for poor customer outcomes but the evidence is lacking as to how volume based commissions results in poor outcomes.

We believe that the commission has erroneously linked volume based commission to poor customer outcomes due to:

Links between misconduct in other areas and financial incentives because, at first glance, it appeared logical to draw this link elsewhere.
Some lenders submitting data in an attempt to push their own agenda to weaken the strength of brokers in the mortgage industry and therefore weaken competition.
Correlation being erroneously treated as causation.
Other data sources have not been considered such as Deloitte Access Economics, the Mortgage and Finance Association of Australia (MFAA) have not been considered and some of Australia's top aggregators like Connective.

Poor recommendations do not benefit mortgage brokers

There is visibility of a broker's recommendations and a high level of competition.

Where a broker puts their own needs ahead of a client, there is a very real risk that a competitor will point this out to a client and the broker will lose the business.

Similarly, the effects of a bad recommendation can be pointed out by an accountant when a client lodges their tax return or by a competitor several years after settlement.

The client may then decide to refinance with another broker or directly with a lender, the broker will have their commission clawed back and the client will not likely refer the broker to their friends or family.

We agree that self-interest is usually a driving factor for behaviour but any perceived financial benefit to encouraging a client to borrow to their limit, for example, is always superseded by the longer term benefits of providing them with a good recommendation in the first place.

As a mortgage broker, you are your own brand and you don't have the backing of a large corporation like a major bank. Your reputation is everything and a poor recommendation today could spell disaster for ongoing business for years to come.

For example, aggregators have data confirming that mortgage brokers aren't submitting a disproportionate number of loans to lenders that pay higher commission. This is strong evidence that giving a client a good outcome is more in the brokers interests than maximising their commission which risks losing the client. So in this case self interest for the broker and the client are aligned.

Our mortgage brokers are specialists in lending to Australian expats, people with unusual employment situations, doctors, the self-employed, property investors, first home buyers and many other good people who are unable to get the finance they need.

Suite 104, 3 Rider Boulevard, Rhodes NSW
2138 **p:** (02) 9194 1703 | **f:** (02) 9475 4466
w: www.homeloanexperts.com.au

Where we have seen brokers put their own interests first has been a result of the personality of the broker themselves and we doubt any legislation or auditing can protect customers from a person without ethical standards.

There are key differences between broker recommendations and many other areas of financial services where misconduct has been seen:

Broker recommendations are easily scrutinised and are subject to competition whereas lenders charging clients inappropriately is often not noticed or understood by clients as this happens when the accounts have been established for some time and the client is not watching the market.
Banks primarily deal with their existing customers via their direct channels because these customers are loyal and don't shop around. The trust level is high, so clients don't question recommendations that may not be in their best interests.
A mortgage brokers' typical client profile is very different because they can easily go elsewhere if they don't feel they're being looking after.

A new remuneration model may cause new problems

Changing to another remuneration structure has the potential to cause significant problems.

It's easy to point out a potential problem but it's much harder to come up with a better solution that doesn't introduce new problems.

The purpose of trail, for example, is to incentivise brokers to stay in contact with their customers and to service their needs for many years after the mortgage is set up.

This includes ensuring that the client is getting a sharp rate and that they are continuing to benefit from their home loan so it matches their long-term goals, whether it's paying off their mortgage as quickly as possible or accessing equity in their property for future investment.

Commonwealth Bank introduced a balanced scorecard for mortgage brokers and we believe this approach of using data and giving feedback to brokers is the key to improving our industry rather than a new remuneration model.

If for, example, you were to have a flat fee for every loan introduced regardless of the loan size then you delink mortgage broker income from lender profitability.

This moves the potential conflict from a broker-customer matter to a broker-lender matter.

The potential follow-on effects of this includes lenders increasing interest rates for smaller loans and offering lower rates for larger loans, punishing lower income households.

We do not know what other unintended consequences would occur and can only speculate on this topic.

Suite 104, 3 Rider Boulevard, Rhodes NSW
2138 **p:** (02) 9194 1703 | **f:** (02) 9475 4466
w: www.homeloanexperts.com.au

Possible solution: banks need to share data

Better data sharing from the banks after a loan has been advanced would allow mortgage brokers to prevent differential pricing for old vs new customers.

Financial planners have a clearer picture of what is happening with their clients as various product providers give financial planners access to data about their clients.

Mortgage brokers face challenges because many lenders will not tell us the current interest rate for our clients.

Improving the data provided in our commission reports would solve this issue and allow mortgage brokers to complete annual reviews easily.

The Combined Industry Forum has been effective

The formation of the CIF was unprecedented, consisting of representatives from the Australian Bankers' Association (ABA), the Mortgage and Finance Association of Australia (MFAA), the Finance Brokers Association of Australia (FBAA), the Customer Owned Banking Association (COBA) and the Australian Finance Industry Association (AFIA).

We believe that this has been a very effective method for our industry to engage with regulators rather than to have an adversarial approach.

We encourage the Commission to carefully consider the points of view of the CIF as we can see they genuinely are trying to create a framework for our industry that includes ethics, the law, the needs of stakeholders and a holistic consideration for how that framework would work in reality.

Self-regulation is surely a better solution than new legislation that may cause more confusion and greater costs to the customer.

We strongly recommend that the RC consider any recommendations made by the CIF as it is the most reliable source of information and thought leadership in our industry.

The future: regulation

We agree with the Commission’s basic principles that our industry should follow.

We also agree that the current regulatory framework is complex and this can cause the industry to lose sight of the broader purpose of what is considered responsible lending and acting ethically.

Suite 104, 3 Rider Boulevard, Rhodes NSW
2138 **p:** (02) 9194 1703 | **f:** (02) 9475 4466
w: www.homeloanexperts.com.au

We believe that the Royal Commission's ideas (mentioned on page 290 of the interim report) are an excellent guide that should be adopted by our industry either as law or via a code of conduct.

The result of more legal restrictions or requirements placed on mortgage brokers will likely see the cost of being a mortgage broker increase and potentially costs to clients increase.

That means additional legislation must be well thought out, have industry input and have a strong benefit to all stakeholders.

A final thought

The complexity and documentation required to obtain a home loan is now at a level that is *maddeningly inefficient*.

Thi cau e co t increa e for lender and mortgage broker a well a fru tration for customers.

This is the root cause of many other issues such as new brokers failing to last more than a year in the industry and customers refusing to switch loans despite seeing constant advertising for lower rates.

A focus on why getting a home loan is now so difficult and if the reasons behind these barriers are genuine or not should be the subject of regulator scrutiny.

The industry is extremely well-run with very few problems so adding more regulations is likely to do more harm than good unless it is very well-considered.

Sincerely,

Otto Dargan
Managing Director
Home Loan Experts