



**Australian Government**

**Productivity Commission**

Submission lodged via website

Dear Sirs,

**Re: Productivity Commission 2018, Competition in the Australian Financial System, Draft Report**

The FBAA welcomes the opportunity to make a submission in response to the Productivity Commission 2018, Competition in the Australian Financial System, Draft Report (“hereafter referred to as the “Draft Report”).

Established in 1993, the FBAA is the leading professional industry body to finance and mortgage brokers, nationally representing over 8,200 members and additionally some 13,000 industry stakeholders.

The first part of this submission addresses specific Recommendations and Requests for Information from the Draft Report. We have only responded to select Recommendations. We broadly support the findings and recommendations in the Draft Report unless otherwise indicated. The second part of this submission provides additional information relating to areas the FBAA considered important.

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Executive Director

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## Part 1 – Response to draft findings and recommendations

### Draft Finding III.1 – CONSUMERS’ CAPACITY TO PUT COMPETITIVE PRESSURE ON PROVIDERS IS OFTEN LIMITED

We agree that consumers have very little capacity to put competitive pressure on providers. This underscores the importance of a strong and stable broker sector because we know that banking practices and banks attitudes towards customers are likely to change very little despite any rhetoric to the contrary. Brokers perform a critically important function of assisting customers to make decisions outside of the influence of a particular provider.

As a collective, brokers have influenced changes in pricing, a reduction in margins and improved consumer access to information to assist with product selection. We accept that there is a wide variance in broker models and that some, vertically integrated models may have biases towards particular product providers however this should not result in all brokers being labelled as conflicted nor is it valid to assert that brokers are failing to deliver benefits to consumers. On the contrary, all consumers of banking products whether sourced directly or through a broker, are beneficiaries of the influence of brokers.

### Draft Finding 6.1 - COST OF APRA INTERVENTIONS ON HOME LOANS

We endorse the observations of the Productivity Commission that the banking sector used the opportunity of APRA intervention on Interest Only Loans to exploit existing customers. We support measures which call this type of unacceptable behavior out and would like to see stronger powers to prevent it from happening.

### **The residential home loan market**

#### DRAFT FINDING 8.1 INTEREST RATES FROM BROKERS VS OTHER CHANNELS

#### DRAFT FINDING 8.2 COST OF HOME LOANS THROUGH BROKERS VS BRANCHES

In our view, the Productivity Commission has erred in its approach to assessing the role, function and impact of brokers.

There is an inference that the role of a broker is to get a lower rate for consumers. Whilst brokers are able to, and often do, secure better rates for consumers than they could otherwise negotiate themselves, this is just one of many services provided by brokers. ASIC’s Report 516 Review of mortgage broker remuneration reported the results of a survey of 490 consumers who had recently used or were planning to use the services of a broker. The survey results identified a wide range of

reasons that consumers use brokers (para 909). Just 35% of respondents claimed that they used a broker to get a better interest rate or deal with 40% identifying access to a wider choice of product.

By misstating the purpose of a broker one is then able to go on to suggest brokers are failing which further allows to suggest the failures are caused by poor disclosure, conflicts and excessive remuneration which in turn supports recommendations for changes.

Brokers increase competitive pressure making all rates lower for all consumers. Interest rate margins have come down. Lending in the late 1970's and through the 1980's, before the emergence of brokers, saw margins above cost of funds of 4-6% on home loans. Today it is around 2 – 2.5%

There is more competition in the home loan market than there has ever been before and all consumers are the beneficiaries regardless of whether they use broker channels or direct.

#### **DRAFT RECOMMENDATION 8.1 DUTY OF CARE OBLIGATIONS FOR LENDER-OWNED AGGREGATORS**

In our view, the majority of the broking profession already acts in the client's best interests.

We have no strong opposition to the concept of duty of care obligations being introduced however we question whether further regulation is necessary when the industry is already mired in legislation, regulations, class orders and regulatory instruments.

A best interests test is a difficult proposition to implement because cost is just one factor when selecting the appropriate mortgage product. We recognise it as a fundamentally important factor, but it cannot be assessed in isolation. Lenders change rates frequently and the lender with the best rate in any given week or month may not be the best rate lender in subsequent months. Extreme care would need to be taken to avoid a reverse onus obligation where a broker must defend an allegation of not acting in the consumers best interests. Flexibility, eligibility under particular lender criteria, consumer preference (or specific aversion), convenience are all elements that may be relevant when sourcing a loan product.

Considerable thought went into the language chosen from the *National Consumer Credit Protection Act* to recommend a product that is not unsuitable but now with the opportunity to look at history and where we are today we support the language through the Combined Industry Forum (CIF) being *"The customer has obtained a loan which is appropriate (in terms of size and structure), is affordable, applied for in a compliant manner and meets the customer's set of objectives at the time of seeking the loan"*.

#### **INFORMATION REQUEST 8.1 HOW SHOULD NEW DUTY OF CARE OBLIGATIONS FOR LENDER-OWNED AGGREGATORS BE IMPLEMENTED?**

#### **INFORMATION REQUEST 8.2 SHOULD CONSUMERS PAY BROKER FEES FOR SERVICE?**

We strongly oppose a 'fee for service' model in broking.

Mortgage broker remuneration is a supply side cost. If a fee for service model were introduced, the cost would simply be put onto the consumer on top of the loan cost. The loan cost /rate offered to the consumer will not reduce if mortgage broker remuneration were reduced or eliminated. product issuer would retain the broker payment,

The FBAA is unsure why there is such focus on mortgage broker remuneration.

We were concerned to see statements from the Productivity Commission in the Draft Report that “costs are relatively high” when assessing mortgage broker remuneration yet it is unclear what they are relative to. Average mortgage broker remuneration across the country is less than \$100,000.

Mortgage brokers incur costs of operating their businesses and in turn are consumers of products and services which delivers economic benefit. Mortgage brokers engage a broad range of services of accountants, lawyers, compliance specialists, advertising and marketing and product suppliers.

There is no suggestion that broker remuneration is increasing rates paid by consumers and we say there is ample evidence that changing broker remuneration will not reduce rates to consumers.

Banks do not offer cheaper rates through their direct channels than loans intermediated by brokers.

There is no evidence that altering mortgage broker remuneration will change the cost of credit for consumers.

Changing broker remuneration will simply destabilise the profession, lead to decreased competitive pressure on banks, increase direct channel conflict (bank branches) and increase product issuer profitability.

## **DRAFT RECOMMENDATION 8.2 MORTGAGE BROKER DISCLOSURE REQUIREMENTS**

The FBAA does not agree that consumers need more details about the process for mortgage brokers selecting a loan.

We were pleased to see the Productivity Commission make observations about the overload of information and excessive degree of detail provided to consumers that they rarely read or understand (p29) but then see a disconnect between this observation and a Draft Recommendation for more disclosure.

Consumers are overwhelmed with the amount of information they must be given by credit assistance providers and credit providers in the course of undertaking a single transaction.

### **Example: Consumer goes to mortgage broker to apply for loan**

At the broker stage Consumer receives:

- credit guide
- quote
- privacy statement
- account opening forms (request for personal details to establish the client as a client of the mortgage broker)
- credit proposal disclosure document

Consumer must provide:

- financial information about income, expenses, debts
- Identity documents

At the lender stage consumer receives:

- Lender's credit guide
- Mortgage documents
- Credit contract which includes a detailed schedule identifying the breakdown of payments, costs, fees and rate. The National Credit Code does not require a credit contract to specify the annual cost rate but rather the annual percentage rate of interest – this is often just a component of the overall cost of credit which under the Code must be disclosed separately.
- **The legislative response to confusing cost rate disclosure is to require lenders to publish yet another rate called the comparison rate that shows the consumer the actual all-in cost rate of the credit being offered. This is not included in the credit contract.**
- Relevant paperwork relating to any Insurances

Over the course of this exercise, the consumer will be asked dozens of questions and be supplied with upwards of 100 pages of information. There is so much information that a consumer does not know what to focus on. Remuneration disclosure is confusing and often leads consumers to question whether costs being disclosed are additional costs or whether they form part of the overall cost of the loan. What the consumer most needs is to know the rate.

We want to see a move away from disclosure being used as a primary risk management tool. Consumers need concise, relevant summaries of the pertinent information rather than detailed disclosure.

Consumers do not have an appetite to read lengthy disclosure and in many cases cannot fully understand it. FBAA does agree that much of the mandated NCCP Act disclosure is unnecessary and consumers do not read or absorb it.

It is not clear why a mortgage broker should be singled out for having to explain in more detail how they go about performing their job. Mortgage brokers are product experts. They know their products and lender criteria. In many cases the specific features sought by consumers or their pre-existing circumstances will already narrow down a large product offering to only a small pool of suitable lenders for whom the consumer will achieve the desired features or meet the lending criteria.

Other professions are not required to descend into minute detail about all aspects of their role. Consumers seek out the services of professionals so they do not have to be subject matter experts on everything. Consumers do not need to know how a baker made the bread – they just want to buy bread.

We do not disagree that some transparency is assistive however the distorted focus on the role of a mortgage broker seems entirely misplaced.

### **DRAFT RECOMMENDATION 8.3 COLLECTION OF HOME LOAN INTEREST RATE DATA**

The FBAA does not support additional reporting requirements unless there is a clear need and purpose. We question the utility of this information being provided and note that it would impose a

significant reporting burden on licensees. We wish to point out that every regulatory cost is ultimately borne by the consumer through higher prices.

#### **DRAFT RECOMMENDATION 8.4 INTEREST RATE TRANSPARENCY FOR HOME LOANS**

In line with our submission above, whilst this information may be of interest to some consumers, the percentages would be very low – from both an engagement and comprehension perspective. The amount of work required to maintain this data is unlikely in our view to justify the service.

#### **DRAFT RECOMMENDATION 8.5 LENDERS MORTGAGE INSURANCE REFUND**

**DRAFT FINDING 8.3 IF YOU HAVE A HIGH LOAN-TO-VALUE RATIO, YOU ARE PROBABLY PAYING FOR IT TWICE OVER**

*INFORMATION REQUEST 8.3 ARE CHANGES NEEDED TO LENDERS MORTGAGE INSURANCE?*

The FBAA has been a long-term advocate of mandating portability for LMI. LMI is the single biggest barrier to consumers being able to switch products (noting that apathy is also a significant factor).

LMI has role to play. Without it, interest rates would be higher as the costs of funds would increase and borrowing above 80% LVR would be curtailed.

The FBAA is the original and leading advocate for better disclosure of LMI. It should be disclosed in the KFS to a Home Loan as agreed by the Treasury NCCP Industry Forum, where progression to implementation stopped on the 15 Feb 2013 due to a pending federal election later that year.

LMI should be formally discussed at the very beginning of the application process by all brokers and bank lenders alike.

Portability and proactive rebates need further discussion albeit the LMI sector will tell us it will only increase premiums which in one way or the other, results in being paid by borrowers.

Any portability or rebate discussion needs to address the fact that Lenders Mortgage Insurers will argue the biggest default risk for them is in the first 12 months, after which the likelihood of default and a claim on LMI diminishes quickly. If LMI providers are able to erode the value of the policy very quickly then the size of any rebate or any value attributed to the consumer when porting the loan may be extremely low.

#### **INFORMATION REQUEST 12.1 POTENTIAL TO INCREASE THE SCOPE OF FINANCIAL ADVICE TO INCLUDE SOME CREDIT PRODUCTS**

*The Commission is considering recommending that ASIC-licensed financial advisers be able to provide advice on some credit products, in particular home loans, personal loans and credit cards. We seek views on:*

- *the merits of such a proposal*
- *which credit products should be included in this increased scope to provide advice*
- *the nature of any duty advisers would have to their clients*

- *different licensing approaches including the form of the licence*
- *the regulatory costs and impact on the industry.*

We do not support making changes to the licensing regimes to allow financial advisers to provide advice on credit products under any arrangements other than those already recognized by the credit legislation.

If a financial adviser wishes to advise on credit products now, they must obtain an Australian Credit Licence or be appointed as a representative of an ACL holder. If they want to give credit assistance in relation to third-party home loans then they must hold the relevant qualification and undertake 20 hours relevant CPD each year.

We see no reason why there is a need to grant any dispensation to anyone from complying with these obligations and there is no reason to attempt to duplicate these obligations in the Corporations Act. While there are many similarities and some overlap, there are significant differences between the credit legislation and financial services legislation and anyone wishing to practice in both fields must be cognizant of both.

#### DRAFT FINDING 13.1 MORTGAGE BROKER COMMISSION STRUCTURES WEAKEN CONSUMER SWITCHING

#### INFORMATION REQUEST 13.2 IS THERE A RATIONALE FOR THE STRUCTURE OF MORTGAGE BROKER COMMISSIONS?

The FBAA believes the Productivity Commission has misunderstood the impact of mortgage broker remuneration. The examination of switching habits of consumers identifies numerous elements that may present barriers to consumers switching (see p383 of the Report under Para 13.4). We do not believe broker remuneration models are a relevant consideration. Mortgage broker remuneration and trail commission do not have any bearing on consumer switching.

The largest barrier to switching for above 80% LVR loans must certainly be lack of portability of LMI which is usually the single largest cost to a consumer and a direct, out of pocket expense. For others, consumer apathy (36% said too much hassle), lack of real variation between products, onerous documentary obligations (responsible lending assessments) are all factors.

A consumer who has been in the same loan for 8 years would not have been subjected to the prescriptive responsible lending assessments that are now expected. Many consumers may not be able to pass an assessment that shows they have capacity to service a new loan if they switch. Consumers are required to produce considerable information about their existing financial affairs because a lender cannot offer a new product until it has made the assessment – the consumers existing record of meeting payments cannot be taken into consideration. Self-employed are particularly disadvantaged by this because they are required to produce so much information about their self-employed income and if using effective taxation structures to legally minimise their taxable income this counts against them in a serviceability assessment conducted by lenders.

There is a cost for distribution across all retail business sectors around the world. In lending it is either the branch fixed costs or the significantly more cost-effective broker variable fixed cost.



Mortgage broker remuneration – both upfront and trail is structured to remunerate brokers for the work they perform. Brokers undertake much of the work on behalf of the lender which would normally be done by branch staff and or head-offices. In many cases lenders require brokers to undertake additional work to help the lender discharge their legal obligations. Making inquiries to satisfy Anti-Money Laundering obligations that apply to lenders and not to mortgage brokers is just one example.

Actions such as finding and originating the borrower (it can take up to 10 interviews to attain the right to work with one borrower), assisting borrowers to navigate the approval process through to settlement, assisting the borrower post-settlement with queries and or issues and conducting reviews of facilities to ensure the loan has not become unsuitable as lending and borrower circumstances change are all within the remit of the broker.

The Draft Report report acknowledges that brokers help smaller lenders achieve greater market penetration they could not otherwise achieve against the big 4. Some have gone further to say they are dependent on brokers to get their product to market.

Trail does not restrict the movement to restructure or refinance a loan should such a consideration be in the best interest of the borrower. If trail stops with the current lender it is then restarted with the new lender.

The focus on broker income also ignores the fact that these payments have no impact on rates offered to consumers. Like any other aspect of business expenditure whether it be advertising or catering, there is a cost to the business for distribution and using the services and the businesses will continue to use those services provided they deem the cost benefit analysis to be in their favour.

We say it is not of real concern that many of Australia's home loan providers do not have empirical data to assess the cost-benefits of using brokers rather than branches (albeit they do). The use of brokers evolved from a clear recognition that the value proposition of using a broker was more attractive than branches and staff. The proliferation of brokers has occurred because of the benefit derived by product issuers from an expanding broker network, and implicitly product issuers know that a broker distribution model is cheaper and more effective than staff and branches which is why it continues to thrive.

## **Clawbacks**

The FBAA is well known for its advocacy against 'unfair' clawbacks and we acknowledge that clawbacks may inhibit the movement of loans/borrowers between lenders albeit to a significantly lesser degree than the factors identified elsewhere in this submission.

It is important to note that clawbacks only apply to upfront commissions, and not trail.

Clawbacks are unquestionably unfair. For a broker to perform their services, get paid for it, then risk losing that income for up to 2 years for matters outside of their control is completely unacceptable and this must change. Clawbacks have potential to compromise a broker's ability to put existing clients' interests first. For example, a broker could place a client into a product with a provider that significantly lifts its rates within a short space of time. If the broker were to switch out clients to a better rate product they would face clawbacks. This leaves them in an impossible situation – even though the reason to change products has been caused by the conduct of the lender and not the broker.

## INFORMATION REQUEST 13.3 WHAT RED TAPE BARRIERS TO SWITCHING PERSIST?

There are numerous red-tape barriers to switching. Broadly they can be grouped into:

- **Conduct barriers** – initiated by product providers; and
- **Regulatory /procedural barriers**

### **Conduct Barriers**

Product providers employ retention teams to interfere with, and frustrate, a consumer's decision to switch.

The tactics employed by retention teams was an issue raised by the FBAA in its submission to the *Credit Card Credit cards: improving consumer outcomes and enhancing competition Consultation Paper* in 2016 and was addressed in the proposed reforms in 2017. The suggestion there was to allow consumers to initiate a switch or cancellation without having to deal with staff of the issuer.

Reform 4 of the credit cards proposals included new requirements including:

- the credit card provider must provide an online means for the consumer to make a request to reduce their credit card limit or terminate their credit card contract;
- following a request, the credit card provider must not make a suggestion that is contrary to the consumer's request; and
- the credit card provider must take reasonable steps to ensure that the request is given effect to.

The FBAA would like to see similar requirements introduced into the home loan space. We do not consider that the current regime provides a level-playing field. Product issuers mistreat existing customers (as identified in Chapter 6 of the Draft Paper titled Banks' responses to pervasive regulation) and then move into retention mode when existing customers get fed up with the mistreatment and initiate a switch. Existing providers can, and regularly do, only offer consumers reductions and incentives to remain after the customer has become so disaffected that they have chosen to leave.

The actions of retention teams extend to frustrating the consumer's attempts to move away. This is done through being slow to process requests, creating unnecessary delays that lead to additional time being required to book in a settlement (up to and beyond 30 days' notice). This causes enormous angst for exiting borrowers, causes further interest being charged and can sometimes lead to default interest being charged.

Mortgage brokers invest considerable effort locating better deals for the consumer only to have those efforts potentially derailed at the final hour by the initial issuer. This type of behavior by product issuers should not be endorsed.

If product providers are prevented from intervening to attempt to change a consumer's mind they may be better incentivised to treat them fairly in the first place.

### **Regulatory/ Procedural Barriers**

There are also regulatory/procedural barriers to switching however any solution to lessen these is unclear.

Switching requires consumers to go through the entire application process again from start to finish. They must receive all disclosure documents from the credit assistance provider and the lender. They must sign and return documents including the credit quote and privacy permission. They must provide repayment statements, proof of income and expenses and meet additional requests which may seek further details about additional accounts or other commitments the consumer has.

As noted above, responsible lending obligations require credit licensees to collect and assess a significant amount of information. The fact of a consumer meeting existing payments under their current facility do not mean they will pass a new serviceability assessment.

When switching lenders, consumers often reorganize their banking which results in having to change multiple direct debits – often each having to be identified and notified individually. They also need to become familiar with the new credit provider's systems (for example online banking), their website, location of ATM machines etc.

Moreover, once they switch, unless they are in a fixed loan, they have no control over future interest rate hikes and out of cycle movements which have become more prevalent over time.

It is conceivable that a universal switching package could be developed to address the main changes that must be taken care of when a consumer changes lender. It is not in any lender's interests to facilitate switching however so there would need to be a fundamental shift in thinking (or a mandate) to cause lenders to collaborate to streamline switching. At the moment, 99% of the work is placed onto the consumer. This is where mortgage brokers perform a valuable service to assist and motivate consumers to switch. The levels of switching would be significantly lower but for brokers.

### **INFORMATION REQUEST 17.1 WHICH REGULATOR SHOULD ADVANCE COMPETITION IN THE FINANCIAL SYSTEM?**

The Draft Report claims that the financial system needs a competition champion (p17).

We have significant reservations supporting the notion that ASIC staff have a great enough understanding of the true mechanics and dynamics of any advice industry, financial services or consumer credit to be able to promote competition. ASIC is essentially a consumer protection body and its view of the world is shaped largely by the misconduct it takes action against. Whilst this

represents a very high percentage of the work it performs, it represents only a very small percentage of participants in the industry.

Without appropriate balance and a deeper understanding of the markets, not enough ASIC staff on the whole are adequately experienced in real-world matters for it to be a balanced “champion”.

A competition champion should not be sourced from regulatory bodies. Such a role, even should it exist, must be performed by a broad mix of people with deep understanding of market dynamics and economics.

## Part 2 - Additional points the FBAA wishes to convey

### **Compare the features of direct channel versus a broker:**

- If a consumer goes directly to a bank they will receive indifferent, 100% conflicted advice. They cannot obtain anything but that lender's products. Lenders are not required to disclose how much their staff are paid or how much profit they make on the loan. That consumer will remain in that loan product for ever or until they actively switch.
- A consumer using a mortgage broker has a choice of a range of products from a range of lenders. EVEN IF the mortgage broker is biased or conflicted, the very worst outcome is that the consumer will end up in the conflicted product – which is exactly the same result that is guaranteed from going to a direct channel. They will have received assistance to lodge the application, will have paid no more, and in many cases less (even if by a small margin) than if they went directly.
- Using a mortgage broker, consumers are told about remuneration splits (by our experience consumers are only interested in fees they pay from their own pocket – if the fees are embedded in the product they have little regard for them).

The upshot of all of this is that consumers are often better off and never worse off using a broker. There is no question that brokers keep competitive pressure on issuers keeping rates lower for all consumers and help smaller players achieve greater distribution.

There is no question a consumer is more likely to switch and be aware of competitor products with the assistance or encouragement of a mortgage broker and conversely would NEVER do so if dealing directly with a product issuer.

In FBAA's submission, all of the attributes of the broker role are positive, or neutral at worst, yet there is a persistent appetite to want to interfere with this. Besides destabilizing the profession, the end goal is unclear and appears mis-aligned with a broader objective of providing consumers with choice, motivation to switch (switching creates competitive pressure) and better information.

### Conflicts of Interest

The notion of conflict as it has been discussed around page 30 of the Draft Report is incorrect. At a basic level, simply receiving remuneration amounts to a conflict – an employee receives more promotion opportunities, or more money, the better job they do. In sales remunerated roles, this is even more apparent, yet it does not always equate to poor outcomes.

Direct channels are 100% conflicted. Brokers must offer a better alternative to the 100% conflict of a product provider. How can a broker with product choice be viewed in a lesser light? At worst a conflicted broker is delivering the same result as a direct channel and at no additional cost to the consumer.

Brokers provide the means through which consumers can switch providers for a better rate or a more suitable outcome. This would not happen but for brokers. A direct channel lender will never tell an existing customer to switch to another product issuer. The measure of the efficacy of the presence of mortgage brokers in the marketplace is not whether they can achieve lower rates than direct channels (because direct offerors will simply match or undercut them) but the pressure on product issuers to keep margins low and to pass discounts on to existing customers.

## Transparency of Broker Remuneration

The Productivity Commission suggests there is no transparency in broker fees, yet the commission disclosure requirements under the NCCP are extensive. So much so, that complying with the very complex disclosure requirements leads to some degree of consumer confusion.

Few other industries have to declare how much they are paid per hour/per job. No retailers have to disclose net profit margins on items being sold at retail. If banks did not pay brokers for their service, that money would remain with the bank – there is no suggestion it would be passed through to the consumer by way of lower rates – in fact the opposite is true.

Lenders are not required to inform consumers about the remuneration they pay their staff. Consumers using a broker are provided with considerably more disclosure than a direct sourced loan.

We appreciate the opportunity to provide this further submission for your understanding. Please do not hesitate to contact me with any queries.

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