Response to Royal Commission Report

February 2019

There are many ways I could write this response & our current thoughts on the outcome of the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry!

It's why I have left it a week to write, trying to take the emotion out of a decision that clearly benefits the interests of the major Banks, & potentially puts up to 27000 (Full Time Equivalents) on the unemployment scrapheap. Pauline Hanson has 'explained' it best when she stated: '*Brokers weren't the focus of this Royal Commission, nor were they the predominant culprits in the predatory behaviour towards consumers.'* Funny, Pauline has it right (Also see link at the end of this Report on a very well written article by PH)!

To be honest, we're still in a state of shock, as are our Clients & Referrers that we've spoken with this week! We have effectively had our business Asset brought down to zero, & our retirement plan in tatters, not to mention the uncertainty over where we may be (as a business & employment) over the next 1-3 years. This has taken 19 years of hard work to build, but destroyed with a stroke of a pen from a Lawyer with no clear understanding of what he's recommended pertaining to the Mortgage Broking industry. And we're only one business in an industry with 17000 businesses.

Do I think that our Industry could be better regulated? Absolutely! Do I think we have too many Brokers? Absolutely! Are there some that do the wrong thing? Absolutely! Have we acknowledged/recognised how many do the right thing, put the Clients interest first, & the hundreds of thousands we've helped get into homes? ABSOLUTELY NOT!

Who do you think wins if the recommendations are implemented? Want a clue (the day after release):

I don't need to explain to you what we do, or how well we do it – our business is 100% referral & that tells you all you need to know (if you didn't already)!

So, let's maintain the course of facts (from my end), with some opinion thrown in (as you know I like to do)…

What was recommended?

> **Recommendation 1.3 – Mortgage broker remuneration**
>
> The borrower, not the lender, should pay the mortgage broker a fee for acting in connection with home lending.
>
> Changes in brokers' remuneration should be made over a period of two or three years, by first prohibiting lenders from paying trail commission to mortgage brokers in respect of new loans, then prohibiting lenders from paying other commissions to mortgage brokers.

There were others including acting in the best interests of the Borrower (derrr), misconduct obligations akin to financial planning (no-one complaining here), & we're to be subjected to the same laws that apply to financial planners in providing financial product advice to Clients (this really shows how little KM Hayne knows about what we do, but the reality is that IF there's any Mortgage Brokers left).

Let's face it, implement 1.3 above & the rest is irrelevant!

In more detail:

I therefore recommend steady but deliberate movement towards changing the existing remuneration arrangements for brokers, **so that the borrower**, not the lender, **should pay the mortgage broker a fee** for acting in connection with home lending.

Changes in brokers' remuneration should be made over a period of two or three years. I would begin with trail commissions. There should come a time within about 12 or 18 months (no greater precision is possible) when lenders are prohibited from paying trail commission to mortgage brokers in respect of new loans. Existing trail commissions would stand unaffected.

Within a *further* 12 to 18 month period, lenders should be prohibited from paying any other commissions to mortgage brokers. Lest there be any doubt about it, my intention would be that the fee payable to a broker in respect of advising about, procuring or negotiating loans after that date would be payable by the borrower, and, if the lender agrees, could be paid out of the principal sum advanced to the borrower under the loan agreement. How the fee is fixed is best left to the market to determine. It could be a fixed amount, a stepped fee, a value-based fee or some combination.

When mortgage brokers are no longer paid by lenders, it may well be that lenders dealing directly with borrowers should be required to charge a fee to recover the costs that would be avoided if the loan were to be originated through a broker, but which are incurred if originated directly. This would be in order to prevent lenders competing unfairly with brokers.

As I have indicated, it may be that to create a level playing field between banks and brokers, **banks should be required to charge a fee to direct customers** based on the costs that are incurred by the bank when there is no broker. I recognise that suggesting that banks charge an additional fee will be difficult for some to understand. But, if brokers are to charge a fee for their services, then it may be necessary for the purposes of maintaining competition, for banks also to be required to do so when directly originating a loan. The fee should reflect no more than the costs incurred by the bank when originating a loan without the assistance of a broker. If only brokers end up charging a fee, customers may cease to use their services, which would eliminate any potential benefit that brokers can have on competition in the residential mortgage market. Both the fee charged by the broker and the fee charged by the bank should be able to be capitalised into the loan.

Further justifies his recommendations with:

Changes of the kind that I have described above were introduced in the Netherlands in 2013. The mortgage broking industry continued without significant adverse consequences to its own operations, the market generally or individual participants.

More on this uneducated statement later…

Flaws in KM Hayne's Report

We have had the following reviews conducted into our Comm's structures over the past 3 years: ASIC, Sedgwick, Productivity Commission, with sign/tick off by Treasury.

The outcome of these reviews, changes to our Comm's structures (that included some of the concerns stated by Hayne) were addressed & implemented. As it stands today, we are paid the least amount we've ever been paid on a transaction, with no 'volume' bonusses (or any other type of additional payment than the standard comm's), & no soft dollar incentives eg holidays etc. While the recommendation was made by the Productivity Commission to cease Trail payments, further reviews into this meant that Trail comm's remained. More on these payments later…

Hayne states that these changes did not go far enough! Well clearly when you recommend the abolition of comm's full stop, you're going to think/say that!

Hayne further states:

Even when the amount of commission paid, and to be paid, to the broker is disclosed, the immediate sting of the payment is not felt by the borrower because it is the lender that pays the commission. On reflection, the borrower may recognise that the cost of commission, like all other costs of the lender, will affect the price that is charged for the loan. But there is not that immediate and direct connection that would be observed if the fees charged by the broker for the work done were charged to the borrower, either directly or by paying the fees out of the amount borrowed.

That's a pretty misleading statement, given that the cost difference to a Borrower is absolutely ZERO when compared to sourcing the Loan directly from a Lender. Furthermore, on occasions, we've actually been able to 'better' the discount for Clients that what was being offered through the direct channel. Can I also add that we even obtained a better rate for Borrowers that aren't even our Clients (that did their loans directly with the Lenders), for NO reward other than the hope of potential business in the future!

The fees charged by a broker were said to be higher than the fees charged for financial advice (the figures quoted were about $6,600 compared with $2,300).

Firstly, we don't set/charge the fee, the Lenders do! More on the amount later (WISH I got paid this much for every loan!!)

Senior and experienced bankers had favoured moving to a system where brokers charged borrowers a fee for the services the broker provided

ONE CEO (CBA's Comyn) has backed this (suggested it to the RC) & Hayne insinuates multiples?? No self-serving interest there is there Matt??

Yet, from another CEO:

A further point, made by Mr Shayne Elliott, the CEO of ANZ, was that moving to borrowers paying brokers a fee for service may penalise smaller borrowers because, for them, it would be uneconomic to go to a broker

Let's see… CBA obtains 40% if its HL's from Brokers, while ANZ obtains 55%... See the differing opinions?

First, the present system of remunerating mortgage brokers is conflicted remuneration. It can reasonably be expected to influence the broker's recommendations about choice of lender, amount to be borrowed, and terms on which the amount is borrowed. And the influence is in favour of the party paying the commission – that is, the lender.

Given all Lenders pay us within 0.025% of each other, hardly cause for conflict! The majority are at the upper end of that scale in any case. Can I tell our biggest challenge in recent times is getting the loan approved for our Clients?! If only it was about what we get paid…

So long as brokers are seen by borrowers to be acting on their behalf, the problem that present remuneration arrangements are conflicted remains unsolved by the remuneration changes proposed by the CIF.

Huh?! Let me get this straight… so long as the Borrower recognises the Broker IS acting on their behalf, the payment of comm's is conflicted??? Scheet! All this time I thought I was doing the right thing by our Clients…

As noted above, CBA assumed in its internal deliberations that the fee charged by a broker on an average loan was about $6,600 and would reduce to around $2,310, in line with the market guidance on the price for complex financial advice

'Assumed' is now a legal precedent for use in a Legal Govt Report… there you have it folks, a major Bank with a seriously vested interest has assumed a figure, by which a Lawyer appointed to conduct a Royal Commission into BANK misconduct, has duly noted & accepted as gospel! How did we ever stand a chance?!

AND, I've left the BEST for LAST:

Changes of the kind that I have described above were introduced in the Netherlands in 2013. The mortgage broking industry continued without significant adverse consequences to its own operations, the market generally or individual participants.

Thanks Mr Comyn, thanks Mr Hayne! He said, he accepted it… BUT, they both ignored (conveniently) the key difference between borrowing in the Netherlands & in Australia. In the Netherlands, **ALL Fees & Interest charges across the life of the loan ARE TAX DEDUCTIBLE**!! That's right, TAX DEDUCTIBLE!! Ooooops, must have overlooked that fact huh!

I could go on & on however I would rival the length of Hayne's Report…

Commissions we receive

We receive an Upfront payment, & an ongoing Trailing payment. Both these payments are calculated as a percentage of the Loan amount.

These amounts (as a % & $ figure) are declared in black & white in our Credit Proposal Reports that every client must sign & receives a copy of. There's NO secret squirrel payments or inducements, just cold hard numbers. This has been the case for at least 5 years. Lender have finally caught up & are also starting to declare what we get paid, though I can assure you that our report is far more accurate & definitive than most of them.

Upfront Comm's

We are paid between 0.625 & 0.65% (+ GST) of the Loan amount depending on the Lender. Our Aggregator (AFG) takes a cut (5%) & we get the rest. This is paid on the NET effect of the loan balance v monies in Offset AC's/Redraw (arising from the reviews mentioned previously).

If a loan is repaid in full within the first 12 months, 100% of our comm's is clawed back. If it's repaid in full within 12-18/24mths, we lose 50%. Additionally, should a bulk reduction be made during these stated periods, the applicable comm's is also clawed back at the same rate. There is nothing in our favour!

Hayne (on the advice of CBA's Comyn) states that the comm's on an average loan is $6600. He doesn't specify whether that over the life (however long that is or just upfront), but it's more sensationalist to leave that detail out hey!

Based on our 2018 Financial Year, our average upfront comm's per Client… $1977 Gross! That's gross to our business before the deduction of expenses & our time. That applies equally to BOTH a purchase, & construction transaction. Those who have used us for their construction loans, think of the time we invested in getting you into your new home, & then tell me whether we have profited in any way from this comm's! What you'll find is the transaction costs us money.

Now, add in Trailing comm's for the average life of a loan (circa 4 years) – Total $3801 (+GST). So from the initial discussion with our Client to when on average a loan is discharged from a Lender, over a 4 year period, we get paid $3801 GROSS to manage & assist you!

Let's just say that if this is all we were to get paid for a transaction ie take away trail & leave upfront comm's in place on the current basis, we are NOT viable as a business. Not possible, unless we introduce a fee for our service.

Trail Comm's

What Hayne said (based on Comyn's statement):

The chief value of trail commissions to the recipient, to put it bluntly, is that they are money for nothing. Why should a broker, whose work is complete when the loan is arranged, continue to benefit from the loan for years to come? It cannot be that they are deferred payment of fees earned earlier when the amount paid as trail depends upon the length of the life of the loan. And it cannot be that they are a fee for providing continuing services given there is no obligation for the broker to do so and no evidence of it being done.

One of the most insulting statements in this report to be honest!

We are paid between 0.15 (+ GST) of the Loan balance in the 1st 3 years with most Lenders. Our Aggregator (AFG) takes a cut (5%) & we get the rest. In year 4, this increases to 0.20%. One Lender of a major steps it up over the 1st 5 years starting at 0.15% & increasing it by 0.05% each year, peaking out at 0.35% in year 5 & onwards. We seldomly use this Lender but all I'll say is don't get nab'bed 😉!

A little-known fact is that Trail comm's originated at the instigation of the Lenders, NOT the Broker! In most parts of the world, Brokers are paid a higher rate of Upfront comm's, but no Trail. At the time of its inception, the UK paid circa 1.2% upfront. The Lenders in Australia said no, this is too high, so let's share the risk. We'll pay you about half as an upfront, & then a smaller amount each year to ensure that we share the risk of only having a short-term client. In effect, this is a deferred upfront fee.

Over time, Trailing comm's evolved to a 'Client Management' payment, by those who value their Clients of course. The payment of this comm's enabled us to employ a Team to follow up & maintain existing Clients. Our Team spends more than 50% of their week maintaining and assisting EXISTING Clients. The Team would say it's closer to 75% min. But NO, according to Hayne, it's money for NOTHING!

Want to know why Banks want this fee gone… (other than the obvious)? In the past 12 months, we have **SAVED our EXISTING Clients over $172,000 in interest per annum**! That's right, $172k out of Lenders pockets & back into yours! This was only possible to the fact we can afford to contact our Clients on a regular basis, made possible by our Trailing comm's!

And it cannot be that they are a fee for providing continuing services given there is no obligation for the broker to do so and no evidence of it being done.

Hahaha!! Of course there's no evidence of this! Why would a Lender have evidence of this? They actually do, but you reckon they're going to release it for political/public consumption? How can I factually publish the figure above, yet with their multi-billion dollar systems & reporting, they can't… You be the judge!

As for 'no obligation' to do so, make it obligatory! Make it so that we have to evidence the work we've undertaken – we have absolutely NO issue with this! But again, that's like the Bank calling you direct & asking if you'd like a cheaper rate… that's not beneficial to them!

Existing trail commissions would stand unaffected.

Want to know why? Because there would be literally a few thousand instant bankruptcies around the Country! Brokers have mortgaged their homes to buy others Trail Books who have retired/left the industry.

Can I also add that the Value of our Trail book is (was) considered a saleable Asset. With the ceasing of Trailing comm's for new loans (slated for 01/07/2020), our Asset is now worthless! That's 19 years of work for retirement trashed! That's like saying to you that your Super Fund that you've been contributing to for 19 years is now ZERO! That's the reality of abolishing payment of Trailing comm's.

What it all means…

Pauline Hanson issued an excellent article on the issue – 'please explain' & she did this exceptionally well (never ever thought I'd say that!)! If you can't access, please let me know I'd I'll email you the full article.

https://www.facebook.com/PaulineHansonAu/posts/940381892832790?__tn__=K-R

The possible outcomes:

1: No change to the current format/structure, though with a significant increase in reporting & monitoring obligations. Obviously, best case scenario!

2: Abolition of (new) Trailing Payments. Asset still worthless. Ability to undertake Client Care post settlement will cease ie reviews/repricing/switching products/resolving queries/issues etc. We will genuinely find this difficult to accept, as we have always cared for our Clients. The only way this could continue (ongoing care/services) is if we were paid a fee, by our Clients. Upfront comm's would need to increase to accommodate our ability to exist. Whether that remains a % of the loan amount, or a flat fee regardless (most likely outcome) would need to be determined.

3: Abolition of all comm's payments ie User Pays (Brokers only). Happy Home Ownership folks – we're done! Most modelling dictates that very few new Clients would pay for our services. The only way this would occur is if they were willing to part with a few G's for us to get them a loan, as the Bank said no (do you know how many Clients we get approved through the same Bank that already said no when approached directly). Imagine if we're not here…

4: User pays BOTH Broker & Lender! Essentially #2 above but YOU'RE paying – we still exist (I think), but as per #2 above. This would be an extremely ballsy decision by any Govt to implement! The other concern I have here is that Hayne has said that the cost can't be more than the 'marginal' cost for a Lender to onboard a Client direct. Hmmm, what do you think the Banks might do?!

What do I think will occur…? Too early to say & will depend on the Government of the day (as stated below).

The optimist inside me says #2 is the most likely result, though with a flat fee model rather than a percentage. I would suggest that more complex deals would attract a fee from the Borrower too.

The pessimist in me says that #4 will happen.

State of play…

As at writing…

Current Government

Officially, they have stated that they will implement all but recommendation 1.3 (in its entirety). They said that payment of Trailing Comm's for new loans cease from 01/07/2020. However, given the reviews by ASIC, Sedgwick & P/Commission, they are not supportive of abolishing Upfront comm's & putting up to 17000 small Businesses out of business. It would also be a brave Government that enforces a Borrower to pay for the privilege of applying for a Home Loan in Australia – as Frydenberg has stated, it's another Tax on the Home Owner!

Labor

Have publicly stated they will implement the recommendations in full, but let's face it, Labor are playing the populist cards at present to win Government, without real thought as to the consequences of their actions. While Chris Bowen (Shadow Treasurer) has said that they will need to take time to consider the recommendations around us, they have not stated that they will support us! It would be ironic the very party that purports to be for the people, would decimate an industry and add another 27000 people to the unemployment queue, not to mention further pressure on social services in FTB payments, Childcare & Private Health rebates, & the education system. Then force you to pay for access to a Home Loan (in light of their Negative Gearing & CGT policies that aim to make housing more affordable)! C'mon Bill & Chris, come out & tell us what you really intend to do!

How you can HELP!

It would be extreme to think that anyone has the time to contact their local MP, so our industry body has made it easy for all & sundry to get involved in just a few minutes of time…

PLEASE PLEASE PLEASE take the time to support us and keep us here for you!

https://www.brokerbehindyou.com.au/

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