MORTGAGE & FINANCE ASSOCIATION OF AUSTRALIA

Trail Commissions

The PC claims there is no evidence that trail commissions on home loans provide an incentive for brokers to achieve good outcomes for their customers.

The MFAA strongly disagrees that there is any demonstrable rationale for removing trail, nor any evidence that it creates poor outcomes for customers.

Trail is an important control mechanism. It discourages excessive churn, incentivises quality, aligns the interests of all stakeholders in the value chain with those of the customer, and allows the broker to continue to provide service over the life of the loan. Moreover, it is contingent income that is only paid if the loan is not in arrears, remains appropriate and did not involve fraud. It is not guaranteed.

If trail were to be abolished, upfront commissions would need to increase substantially so that brokers' net earnings are not impacted over the life of the loan. This would equate to the Canadian model, for example, that pays an average upfront commission of 1.1 per cent.

In addition, the removal of trail will reduce brokers' capability to produce a business that has annuity income, which would underpin the business' value for potential future sale.

As recently reported by Deloitte Access Economics, brokers who are sole traders earn an average of $86,400 before tax, making their businesses vulnerable to any reduction in income. Any move to remove trail commissions would benefit lenders, weaken the broker channel, decrease choice, competition and the outstanding service brokers provide, which would be a poor outcome for all consumers, particularly in regional and rural Australia.

However, it is important to remember these are recommendations, which will be considered by Government alongside reports and submissions from ASIC, Treasury, the Royal Commission, industry bodies and others. In light of this, we should remember that neither ASIC nor Treasury has called for the banning of trail.

Indeed, ASIC noted in its Review of Mortgage Broker Remuneration that *"the payment of ongoing trail commissions usually provides an incentive to aggregators and brokers to put forward higher quality loans where consumers are less likely to default on their obligations…the option to waive trail commissions in favour of an upfront payment removes this incentive."*

The ASIC Review further stated, "*based on the data we reviewed, we did not identify trail commissions directly leading to poor consumer outcomes."*

In its submission to the Royal Commission in July, Treasury stated that it is possible that trail creates some perverse incentives. However, its submission also stated that *"the removal of trails would…reduce incentives for brokers to guard against arranging non-performing loans and to not unnecessarily switch consumers to alternative loans that do not provide for a better deal…. Services provided by brokers to customers after a loan has been arranged could also be affected if trailing commissions were removed."*

Upfront Commission

The PC's Report has ruled out either a consumer or lender-paid fee for service. Indeed, the PC has proposed that the current upfront commission structure should remain, echoing the Combined Industry Forum's recommendations, saying, "*upfront commissions to aggregators and brokers to be paid based on the funds limit drawn down by customers, net of offset, instead of the limit of the loan facility.*"

The Report states that *"fixed fees paid by customers rather than commission structures have been proposed, and would eliminate conflicts, but the cost to competition would be high. Consumers would desert brokers, and smaller lenders (and regional communities with few or no bank branches) would suffer much more than larger lenders, if customers were required to pay for broker advice"*.
The Report also acknowledged that broker businesses need to remain commercially viable, recognising the critical role played by the broking channel in our economy.

Other key recommendations

Unfortunately, the Report does not acknowledge other reforms already put forward by the Combined Industry Forum (CIF) - some of which have already been implemented - designed to further strengthen strong customer outcomes across the industry, and which include a higher obligation to customers than is currently required by law.

While the MFAA agrees that more can be done with regards to having a "positive duty" to act in the customers' interests, a best interests test would be inappropriate.

Given the significant size of aggregator lender panels, a best interest test is impractical. It could also produce excessive contingent risk, resulting in brokers limiting their number of accreditations which would restrict new lender entrants and, again, diminish competition and choice for consumers. The MFAA would support a priority of interest duty that puts customers' interests ahead of industry participants' interests.

The comments on volume and campaign-based bonuses raised in the Report are not accurate. Volume bonus and campaign-based commissions have been ceased and this has been communicated by the Combined Industry Forum to both ASIC and Treasury.

Finally, the Report's authors have also suggested that the clawback period be limited by ASIC to 18 to 24 months. This is already standard across the industry.

Overall

A positive outcome is that the Report has acknowledged that brokers drive competition. While we can disagree on the methodology used to enact reforms, we can agree that any proposal that would weaken the broker channel is not advisable.

The Report notes that the home loan market is now "*intimidatingly complex and confusing*," and that *"brokers can make the home loan market more competitive by increasing consumers' knowledge of loan products and exerting competitive pressure on lenders on behalf of consumers,*" and that "*brokers enable smaller lenders to diversify and compete with lenders that have branch networks."*

The Report also acknowledges that "*for smaller lenders and those without widespread branch networks, brokers enable diversification and growth in their loan portfolio. For example, non-bank lenders and foreign banks operating in Australia rely on brokers for over 90 per cent of their loan book ... on average, each smaller lender would have needed to open 118 new branches to generate the equivalent market share achieved through use of brokers*."

Finally, the PC has accepted that *"many brokers are likely to be motivated by the welfare of their clients, whether due to their reliance on these relationships for future business or the intrinsic value they derive from providing a good service."*

We agree. As you all know, mortgage brokers continue to be focused and dependent on building strong relationships with their customers. These existing relationships, both directly and indirectly, make up 70 per cent of mortgage broker business, giving brokers a strong incentive to provide a competitive and valuable service both at the time of origination and over the remaining life of the loan.