



Department of the Senate
PO Box 6100
Parliament House
Canberra ACT 2600
Australia

16th February 2011

Attention: Senator David Bushby and
John Hawkins
Secretary

Senate Economics References Committee

*Submission to the Senate Economics References Committee
Finance Brokers Association of Australia Ltd (FBA)*

General Positioning Statement:

It is of primary concern to the FBA that various moves and initiatives by the major banks are an endeavour to erode competition in the market place and to create perceived consumer benefits and advantages that don't really exist.

The Association strongly supports the value and professionalism of brokers in the Australian market. As a part of this it has established the TFP Co-Operative Ltd which is a platform that enables brokers to access a large variety of products which assist their business to increase revenues, reduce costs, and to access certain products not available or not readily available to them. These include access to mortgage debt products via the non-ADI sector noting this is not an aggregation platform.

It is imperative that before decisions are finalized which are based in part on current theories and commercial self interests, that the practical implications and true understandings of how various mechanisms and products work in the lending sector are further clarified so to ensure the benefits or risks to the consumers are clearly understood, and that the competition in the marketplace which has driven enormous benefits to consumers by way of far more competitive interest rates and a far broader choice of products than was available in our industry's past, are not eroded or even worse possibly extinguished.

Background :

The FBA was established in 1992 and is run by an elected Board of Directors whereby its Members are primarily finance brokers across all lending sectors (ie loan writers – commercial, consumer, chattels, etc) and whereby each member must abide by our Code of Practice. The Board of Directors are all long-term current practicing industry participants (brokers) representing through its membership base approximately 8,500 brokers, and via our Magazine reaching approximately 26,000 industry stakeholders.

Peter White (author of this document) has been in the banking and finance sector since 1979 and has held executive and various other positions within the Commonwealth Bank, AGC Finance, Executive Manager RAMS Home Loans, CEO of Wizard Home Loans, Associate Director of AIDC Ltd, and have held various other industry roles in the non-banking sector in the capacity of General Manager CEO and Managing Director, together with today on behalf of the FBA being the Chairman of the Board of Directors / elected National President for a second 2 year term / Chairman of the National Lenders Consulting Committee and AML/CTF Sub-Committee / and sits on the Industry Consulting Committees to The Treasury, ASIC, Attorney General's Department, and ATO-FSIP Committees. Additionally when required has acted as an Industry Expert Witness for NSW Local and Supreme Courts.



FBAA Matters of Concern to Industry and Consumers in relation to the current Banking Reforms :

Exit Fees

The primary importance that practically needs to be understood is that all Banks and Lenders are commercial in nature. In that they must make a profit, and their shareholders are the primary concern, second is the consumer.

In or around the mid 1990's Deferred Establishment Fees / Exit Fees / Early Termination Fees were introduced as consumers wanted to minimize the up-front cost of establishing a loan facility especially in the non-bank/non-ADI sector, and bank home loans, and as facilitated and sold by finance brokers.

There is a real tangible cost to 'writing a loan' which has a commercial impact, as does the manufacturing production and sale of any product. This commercial cost cannot be ignored, and should not be hidden elsewhere. Removing the same will have an impact which most likely will not be to the benefit of the consumer borrower as it has the potential to significantly increase the cost up front to obtain a loan.

If the Government enforces Banks to remove Exit Fees and the Banks do not replace that revenue-stream elsewhere it would reduce their profitability, erode the return to shareholders, and reduce the value of their shares on the Stock Exchange. Commercially that would not make sense nor be accepted in a commercial enterprise, therefore the loss of such revenue would be made up elsewhere so not to erode profits and maintain the returns to the shareholders. The question is where will that lost/replacement revenue be made up.

The impact of where this 'lost/replacement revenue' might be leveraged is not understood by the consumers.

For example to compensate for this lost revenue, interest rates may be increased which over the life of a loan could result in tens of thousands of dollars in additional interest being paid by the borrower, verse a once-off \$700-00 fee. Increases made on leveraged against Lender's Legal Discharge Fee, additional or increased monthly loan fees, other fees not ascertainable at this stage may be added to the cost of borrowing, lower interest rates may be paid on deposit holdings without any reduction in lending interest rates hence potentially increasing profit margins to make of these lost revenues.

The other impact of removing Exit Fees is the impact to the Broker Industry. Banks have assisted in growing this market space via Aggregation so to gain greater market share and increased volumes. Given the already stated 'commercial nature' of the Banks, with the proposed removal of Exit Fees the concern is that the Banks may look to increase 'upfront commission claw-backs' which already extend in some case to 100% of the upfront commission payment to the broker being 'clawed back' for the first 2 years of a home loan if it is discharged, together with the real possibility of even further erosion of income to the broker through further reductions of the upfront commission and or trail income.

All of the above considerations separately or combined would have a significant impact on the broker market place, and would potentially destroy and or greatly damage the broker industry which grew significantly in the early 1990's due to consumer demands for greater competitiveness and the need for far better service. It was the large positive impact of brokers assisting consumer borrowers with their needs who forced the Banks to reduce margins so to compete with this sector, and later the Banks introduced mobile lenders to meet the demands of the consumers and their neglected customers (not a proactive direction by the Banks to listen to their customers in the first instance).

If the Broker marketplace is destroyed or eroded so will be the high level of service enjoyed by consumers today, there will be greatly reduced competition for the banks and the benefits that this has bought to the



consumer marketplace for the best part of the past two decades. Any reduction or lack of competition will have an enormous negative impact to consumers as it would allow the Banks to revert to the 'old days' of ruling the system, and destroy an industry which has been to the significant benefit of the consumers. Prior to the growth of finance brokers from the 1990's and the advent of the Non-ADI Lenders, banking margins on home loans were up to 4% above cost of funds, today it is significantly less. Competition equals consumer choice and benefit.

Additionally now with consumer finance brokers being licensed and regulated under the NCCP, the finance broker is the only independent professional advice on consumer debt that a consumer borrower has.

Today we are already seeing the marketing and advertising impact of such considerations as the 'banking spin doctors' try a grab for home loans from each other so to gain greater market share on a perceived short-term advantage. The total impact to the borrower has not necessarily been considered with this rather being a marketing and advertising ploy to snatch business.

Additionally this style of advertising currently being deployed by the NAB Bank in saying they have broken up from the other Banks suggests historic collusion on how banks charge consumers fees and set interest rates.

The removal of Exit Fees will significantly and negatively impact consumers and the broker industry as detailed above, and potentially may destroy the non-bank/non-ADI sector which bought competition to the consumer home loan marketplace by deferring what was normal up-front costs to establish a loan. Therefore if this happens it removes competition and creates a new environment of fees or interest rate rises thereby allowing the Banks to 'write their own rules' once again – a backwards step.

It is important to note however any Exit Fee must be commercially reasonable and tangible to the cost of doing business – and not a fee grabbing exercise.

Separately on the basis of making it financially easier for consumers to switch lenders, Exit Fees are not the only hindrance to refinancing a mortgage. The actual processes employed by the banks internal departments which handle Discharge Documents and Payout Figures etc, use erroneously long delaying tactics which hinder and frustrates consumers and industry participants when trying to refinance a mortgage and or discharge the same, and in some cases causes additional interest to be charged as settlements become delayed due to this delaying tactic – not something in the consumer's best interest. We are advised that the Banks Client Retention Teams are driven by KPIs that dictate their salary package bonuses and therefore they do all things possible (rightly or wrongly) to retain clients whom are virtually at the end of the process for discharging a loan or endeavouring to refinance a loan, by attempting to retain the client by using lending terms not normally available under normal circumstances (ie. lowering interest rates, fees being waived, loan terms extended, etc). A last minute grab to hold onto the client as it is well known in the industry that it is cheaper to retain a client than to find a new one.

Therefore albeit Exit Fees are a very real issue they should not be removed as it will be a cost impost to the consumer elsewhere and most likely an upfront cost to the consumer, it is not the problem that really disadvantages consumer borrowers when refinancing as demonstrated above. Further and greater reforms in the interest of the consumer are needed.

Portability of LMI (Lenders Mortgage Insurance)

LMI as such is an insurance product that is subject to the general provisions of the Insurance Contracts Act (1984), yet does not abide by such.



As a product, LMI is there to protect the Lender (only) from losses incurred in the case of default in the sale of a mortgaged property by the Lender as a mortgagee in possession. It gives no protection to the consumer borrower, in fact if there is a claim paid against the LMI policy, the Insurer will then go after the borrower to try to reclaim their losses from the paid claim.

A large percentage of consumers are not aware of this due to the lack of appropriate and clear disclosure of the same.

To this point the consumer borrower is highly disadvantage:-

- there is no PDS on the LMI product – a breach of the Act in itself
- there is no choice of LMI Providers given to the consumer
- there is no benefit to the borrower but only the Lender for the loan term
- the premium is paid from the loan funds borrowed by the consumer based on the LVR (loan to valuation ratio) as a percentage of the debt which could be a premium of up to 2.40% and on a loan of \$350,000-00 this is \$8,400-00 plus charges and duties
- if the loan is discharged early there is regularly no premium rebate to the borrower albeit in some cases it is 'partially' available for the first 2 or 3 years of the loan only (and note the premium is paid based on the total loan term not just 2 or 3 years)
 - this rebate is not on a pro-rata or proportional basis given the total period covered
 - in some cases if you don't ask for a rebate/refund on the premium you won't get it as only some LMI Providers have an automatic system to do this – others do not. Colloquially if you don't know you don't get, and you can't ask for something you don't know about
- a significant lack of disclosure exists as there is no PDS given to the client
- no choice of provider
- no benefit to the consumer albeit they pay for it

There is also a lack of disclosure of commissions (if any) paid to banks/lender for the sale of LMI and it is believed that there are no commission claw-backs to them if a policy is terminated at any stage – a matter of discussion by those receiving such payments to advise on.

As understood, LMI cannot be transferred from one loan or bank to another (portability).

Under certain conditions this product should be capable of being portable if the debt size, the supporting security property, and the repayments are under changed one should be able to move the cover across between lenders. This being said any deviation from the original debt being refinanced will vary the insurer's position and therefore need a formal and separate review.

If a variation is accepted by the insurer, the consumer should only incur the cost of the difference between the reviewed premium on the original debt being refinanced *less* the premium already paid.

There are issues of course that varies the risk to the lender and insurer in portability of LMI, but it should be allowed under the right circumstances.

At the very least there must be an appropriate refund/rebate based on a premium that covers the bank for a 20, 25 or 30 year loan period if the policy is terminated at any time, and not just a partial refund in the first two or three years of the loan if it is asked for (note: in today's market some banks may also own or have interests in LMI Providers – possibly why these issues have not been dealt with before).



Securitization Sector

This style of funding structure has been used by ADIs and Non-ADIs extensively over the past 15 years or more, so to take the debt risk off Balance Sheet.

Albeit having its issues through the GFC which are well known, and whereby the Australian market was not the issue – we just got side-swiped by the errors of the Investment Bankers mainly in the USA, the capability to fund debt via this structure bought competition and lower interest rates to the consumer borrower in the 1990's by the likes of Aussie Home Loans, RAMS Home Loans, Wizard Home etc, and notwithstanding the widespread use of this structure by the Banks.

This is a very important part of funding into our industry and needs the support of Government to regain consumer and corporate investor confidence so to maintain this industry need and consumer benefits it brings by way of reduced costs to fund a lenders mortgage pool (under normal conditions).

To support the needs of this industry and to retain competition in the lending market space, it is recommended that the Government should consider the support of the sector by issuing/supporting with Government-Backed Bonds in conjunction with the mortgage asset / RMBS in the securitization structure, which will enable strong confidence from the corporate investor to buy the same and at reasonable pricings, which will in turn keep interest rates down and re-instill strong consumer confidence when borrowing under this style of structure.

Additionally and separately, it should also be noted that a large issue in today's lending market is the current lending parameters and environment by banks to the SME Debt sector, whereby the SMEs in our country employ a large proportion of consumer borrowers.

Through the GFC banks reacted negatively to SME Borrowers by reducing LVR parameters and at times without notice or little notice to existing SME borrowers even when an existing borrower had an unblemished credit history, and increased serviceability requirements for new SME borrowers and imposed much lower than historic LVRs to be geared.

This meant debt was harder to obtain or retain (little own increase debt to support or grow a business) with the benchmarks moved to unreasonable levels, and in some cases the reduction in the LVR meant that SME Borrower/s had to find significant amounts of cash to reduce debt or they would be placed into default without cause of a poor repayment history.

The outcome, the SME borrower is/was forced to reduce the debt and in many cases the only way to compensate for that loss of cash reserve is/was to put off employees so to enable the business to survive – to the detriment of our consumers borrowers.

It is recommended that Government consider the establishment of a Development Bank or SME Bank either as a Government Owned Bank or a Government and Private Enterprise Joint Venture, so to support appropriate styles of borrowing structures as needed for SMEs to maintain and grow their businesses, and so to be able to continue to employ our consumer borrowers.

The Government in the late 1990's sold off a non-core asset known as ADIC Ltd, which I was a Associate Director of. This company had an excellent model whereby it held a strong securitization structure and provided excellently tailored debt for SMEs and larger corporations. Once AIDC was sold it left a hole in the market which has sadly never been filled.

The SME area of lending and support to SME borrowers has been neglected by the Banks and its lending strength is seriously needed for our future in supporting business debt in an appropriate fashion as the banks have shown they simply don't care and re-write the rules as they see fit without cause and



consequence to the detriment of the SME borrower, which has its negative on-flow to consumers by reduction of employment. The template is there in what was AIDC Ltd.

Credit Cards

In my 32 years of working in this industry, I do not recall any instance whereby if interest rates went down that Credit Card Interest Rates were adjusted downwards accordingly in part or in full, as do home loans for example.

Interest Rates in this area appear to have always risen or plateaued but never reduced, and Australia on a per capita basis is one of the highest users of credit cards in the world.

I request on the Government to hold an inquiry into the banking practices in relation to the setting of Credit Card Interest Rates in line with cost of funds movements, and fee charging behaviors which also seem near impossible to accurately reconcile for a consumer.

Creative advertising might lead a consumer to 'rightly or wrongly' believe they are getting a cheap credit card (and in some minor cases they might be), but in the fine print if you can read it on the TV screen which only lasts for seconds, interest rate discounts generally only apply to 'existing debt transfer balances' not the usage of the card or cash advances which is where the main account activity occurs.

Given our high usage of such debt there needs to be greater and clearer disclosures on advertised discounted interest rates, which under the NCCP this may prevail, and investigations into the movement of interest rates which have only varied upwards even if the cost of funds reduce.

Again the Government needs to hold an Inquiry into this price-setting practice as consumers use this product in a significant fashion, and the Banks should be accountable for their interest rate movements.

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Thanks you for the opportunity to place this submission and to appear before the Committee at the hearing to be held on the 4th March 2011 in Brisbane.

Yours faithfully

Peter J White JP AFB CPFB
National President and
Chairman of the Board of Directors