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Mr David Murray AO
Chairman
Financial System Inquiry
GPO Box 89
Sydney NSW 2001

By email: fsi@fsi.gov.au

Dear Mr Murray,

Thank you for the opportunity to provide a submission to the Financial Systems Inquiry (FSI).

I appreciate that this submission is outside the formal lodgment dates, but trust that the Panel will consider my comments in some form during their deliberations.

About AFG

Australian Finance Group (AFG) was established in 1994 as an aggregator, providing mortgage brokers with access to a broad range of financial products. The company has grown to become one of the largest providers of mortgage broking services in the country, offering more than 1,350 financial products from Australia's leading lenders across a network of more than 2,000 brokers.

AFG's service offering has also diversified to include commercial finance, insurance products, property development and AFG-branded and securitised products.

The Current State of the Mortgage Broking Sector

AFG notes that one of the key objectives of the FSI is to foster a competitive financial system, and in this context the mortgage sector is at a critical juncture.

Since AFG was founded the Australian population has grown by 25 per cent. Over the same period the number of lending institutions active in market has more than halved. This has had a significant impact on competition and innovation in the sector.

The consolidation of the mortgage sector around the large 'too big to fail' banks has resulted in a situation where products from these organisations now account for 88 per cent of Australia's mortgage volume. The presence of the mortgage broking industry is one of the few factors preventing the further entrenchment of the vertically integrated banking sector in the mortgage sector.

The mortgage broking industry provides customers with access to a range of providers, and represents around 50 per cent of the mortgage market (source MFAA), with AFG comprising 22 per cent of broker market and 11 per cent of the overall market (based on ABS data). Through their choices, consumers are clearly indicating high level of comfort with the current broking model. Proposed changes are merely seeking to manipulate consumer preferences.

A viable mortgage broking sector is crucial for retaining an element of competitive pressure in the mortgage market. Many of Australia's smaller banks rely on mortgage brokers to act as a de facto distribution network for their products. Without access to the network of mortgage brokers provided by the likes of AFG, these organisations would simply not have the resources to get their product to market.

Industry Regulation and Oversight

The mortgage broking sector is highly regulated, and justifiably so. All broker mortgage deals are placed under tough scrutiny, and brokers are heavily regulated by ASIC and NCCP laws.

Brokers are required to disclose any commission and fee payments they may receive from the sale of a product.

To protect both the issuer, and the customer, from the provision of an inappropriate product, brokers also face a 100 per cent 'claw back' of their commission over the first 12 months, and 50 per cent over 18 months, of a deal loan's life. Brokers cannot 'burn and churn' and are required to follow strict processes to ensure that the loan they provide is not unsuitable for the customer's needs.

These measures have been highly effective in regulating the operation of the sector. AFG's loan book is currently at $90B and is experiencing its lowest 'run off' in the company's 20 year history.

Impact of Changes to the Commission Model

Despite the fact that commissions are already disclosed with complete transparency, some submissions to the FSI are seeking to undermine the broking model under the alleged banner of 'transparency' by proposing the abolition of the commissions based broking model in favour of a fee based model.

The proposal being promoted by some interests would result in mortgage customers being required to pay a direct fee for mortgage broking services. Under such a scheme it is likely that potential customers will seek to avoid this payment by engaging directly with a mortgage vendor at the branch level, where no fee would be applicable.

Corralling mortgage customers into bank branch networks will have an extremely detrimental impact on Australia's remaining second tier lending institutions. The loss of the broker based distribution network would put these lenders at a major disadvantage to the large banks. The resources required to establish a physical branch network to compete with the large banks creates an almost impassable barrier to entry.

By undermining the broking model the proposals before the FSI would ultimately result in a significant reduction in competition in the mortgage sector, to the detriment of the consumer. Every mortgage customer will pay for reduced competition throughout the life of their loan.

Furthermore, the mortgage broking sector itself would be severely impacted by the changes. With thousands of brokers across the country, and around a further 60,000 jobs tied to the industry, the consequences should not be underestimated.

Conclusion

Mortgage broking is a professional industry that understands the value of medium-long term client retention. AFG has spent tens of millions of dollars on a highly successful client retention strategy that is strongly supported by our membership. Disclosure, trust and high quality service are central to this strategy, and are fully supported by the current regulatory regime.

Attempts to promote a change to a fee based model should be seen for what they are – moves to further entrench the 'too big to fail' vertically integrated banking sector in the mortgage sector, at the expense of competition and to the ultimate detriment of the customer.

AFG would welcome an opportunity to discuss these issues further with your Panel, or its officers, should you wish.

Yours sincerely,

Brett McKeon
Managing Director
AFG

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