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Draft Prudential Practice Guide 223 Residential Mortgage Lending

Submission by the Finance Broker's Association of Australia Limited

This is a submission made on behalf of the Finance Brokers Association of Australia Limited (FBAA) in response to the Draft Prudential Practice Guide 223 Residential Mortgage Lending released by the APRA on 26 May 2014.

The FBAA

The FBAA is a not-for-profit organisation that represents finance and mortgage loan writers throughout Australia. The FBAA was established in 1992 and is run by members, for members. The FBAA currently reaches 9,500 finance brokers through its members across Australia and about 14,500 industry stakeholders. The FBAA seeks to promote best practice throughout the finance brokering profession, represent its member's interests and seek to ensure the financial sector operates in fair and open manner. The FBAA is committed to ensure that the practical implications and effect on both consumers and brokers of financial legislation, policy and industry practice are known, understood and regulated appropriately.

This submission is in response to -

Remuneration - paragraph 18 of the draft guide provides, "[I]n Australia, it is standard market practice to pay brokers either an upfront commission or a trailing commission, or both. Experience has shown that commissions paid upfront tend to encourage less rigorous attention to loan application quality. Trailing commissions are more likely to provide incentives for brokers to retain and monitor customers. A prudent approach to use of third parties for residential mortgage lending would include appropriate compensation measures for brokers. Such measures include the ADI being able to end or claw back commissions where there are high levels of delinquency or process failures on loans originated by third parties".

The FBAA disagrees with this statement as not being an accurate representation of the remuneration arrangement for most brokers in the residential lending industry for the following reasons:

1. Smaller upfront Commissions

A large number of brokers are being paid a smaller upfront commission with trail commissions making up a majority of the commission payable for a successful loan arrangement being entered into. It is generalist to suggest that instance where borrowers either default or refinance their loan are, in the majority of instances, representative of the conduct, care and skill of the broker.

Brokers assist lending institutions, particularly the major ADI's, in seeking new or continuing customers. Brokers are provided with the lender's requirements and they seek to arrange and co-ordinate, on behalf of the borrower, the requisite information and supporting evidence for the ADI to assess and determine whether it will lend to the borrower. The information requirements and evidence are dictated to the broker by the lender. The instance of a larger upfront commission does not obviate that the final lending decision is that of lender, based on the lender's requirements.

As noted in the FSB Principles for Sound Residential Mortgage Underwriting Practices it is the responsibility of the lender to put in place measures to ensure responsible inquiries have been made to ensure that responsible and viable lending takes place.

2. Non remuneration for unsuccessful loans

The commission structure does take into account the countless borrowing applications that are unsuccessful. Brokers are not remunerated for unsuccessful loan applications, despite the time and effort spent in seeking to assist potential borrowers.

3. Claw Back

Finally, the statement does not take into account the “claw back” of both the upfront and trail commission that occurs when a borrower defaults on a loan or if the loan is subsequently refinanced. Both default and refinance are not the fault of the broker. RBA figures for September 2011 noted that Australian banks have one of the lowest non-performing loan rates out of 97 economies that were surveyed. Further, in a competitive home loan market, borrowers are more aware then ever of their ability to get a “better deal” and are more than willing to change lenders.

Overall Conclusions

Brokers are not employed by lenders however, they directly and indirectly market the residential lending products of financiers when seeking to assist potential borrower's. Brokers sole source of income is by way of up front and trail commissions earned from successful loans being written. Commissions, both upfront and trail are subject to claw backs if loans are defaulted upon or refinanced.

The FBAA does not support the change in the current commission structure, to seek to remove further commission payable to brokers when the overarching decision to lend to the borrower is made by the lender. The removal of the role of the broker in mortgage lending will reduce consumer access to mortgage lending and will overall slow and diminish residential lending in Australia.

For further comment, queries can be directed to:

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