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APRA DRAFT PRUDENTIAL PRACTICE GUIDE ON RESIDENTIAL MORTGAGE LENDING

APG 223 – RESIDENTIAL MORTGAGE LENDING

RESPONSE BY MORTGAGE AND FINANCE ASSOCIATION OF AUSTRALIA

THE MORTGAGE AND FINANCE ASSOCIATION OF AUSTRALIA (MFAA)

MFAA is the peak professional association for mortgage and finance brokers, mortgage managers and aggregators in Australia (known under MFAA's robust accreditation regime as MFAA Credit Advisers).

MFAA's membership comprises 10,378 members. It is estimated that this accounts for some 75% of all mortgage and finance brokers in Australia. In its recent authorisation of the MFAA Disciplinary Rules ACCC commented that *the association imposes 'higher educational and professional standards on its members than required under the NCCP Act'* [1]

Mortgage brokers (the vast majority of whom are MFAA members) are now responsible for one in every two residential mortgages transacted.[2]

DRAFT PRUDENTIAL PRACTICE GUIDE 223

MFAA welcomes the opportunity to comment on the draft guide as released by APRA on 26 May 2014. We support the initiative of providing ADIs with guidance on sound risk management practices for residential mortgage lending, however there are some comments in the draft guide, relating to the operations of mortgage brokers about which we have detailed knowledge, which require informed comment by us.

Throughout the document there seems to be an undertone that third party or mortgage broker initiated loans are inherently riskier than other sources of loans.

There is no evidence to support this view. On the contrary MFAA in this submission will provide evidence which shows that broker-initiated loans are of, at least equal, if not superior quality, to those initiated via proprietary channels.

But firstly some commentary on the undertone mentioned above:

Guide 6 (a) lists amongst the examples of loans with differing risk profiles 'third-party originated loans' as if they were a special category or type of loan. It is inappropriate to include third party loans on this list as if they were a special category of loan. Third party loans could, and do, include all the other categories of loans listed as well as prime loans, just as proprietary channel originated loans could and do. They are not a category in themselves.

First Home Buyers, property investors, and borrowers with more complex situations tend to seek out brokers for credit advice and these customers tend to have higher LVRs, greater exposure to interest-only loans. However it is the products that are appropriate for customers that gravitate to brokers, (but also available through proprietary channels), that need to be measured more stringently for risk, not the brokers themselves.

Guide 16 (d) specifies the need to have reports on broker relationship and performance. While that, in itself, is prudent, to single brokers out with no mention of a report of proprietary channel performance is inappropriate and misleading.

[1] Deputy Chair of ACCC, Delia Rickard

[2] Research by *Comparator* for the March Quarter 2014 showed that mortgage brokers originated 50% of all residential mortgages in that quarter.

Guide 18 makes the following comments:

> *"experience has shown that commissions paid upfront tend to encourage less rigorous attention to loan application quality".*

There is no evidence for this assertion. MFAA will provide evidence that this assertion is not correct.

> *"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"*

There is no evidence of high levels of delinquency or process failures on broker originated loans. However the guide fails to consider the possibility of high levels of delinquency or process failures in proprietary channel originated loans.

ADIs currently do not claw back commissions on delinquency, but they do stop paying trail when a loan falls into arrears. We believe this is more than adequate as delinquency is often caused by a change of circumstances for the client such as unemployment, sickness, divorce, etc. Brokers should not be penalised under these circumstances as brokers cannot influence the outcome.

It is not clear from the guide what is intended to be covered by 'process failures'. However if this refers to, or encompasses, poor documentation - generally a loan is not accepted by a lender from a broker if all documents are not presented. There is no evidence that broker loans are more deficient in this aspect than proprietary channel loans.

Guide 19 proposes that:

> *"a prudent ADI would recognise the incentives and potential risks inherent in its broker remuneration structure. It would have in place appropriate monitoring and controls to guard against incentives to pursue loans with inadequate or false verification, marginal serviceability, excessive leverage or unsuitable terms for a borrower."*

but makes no mention of such issues with proprietary channel originated loans.

Guide 22 asserts that a reliance of third-party originators '*can potentially lead to additional risk and give rise to higher levels of exposure that may be outside the ADI's risk appetite.'* But no evidence to support this assertion is provided.

CHECKS ON BROKER PROFESSIONALISM AND PERFORMANCE

Loans from brokers face a range of checks, including the requirements under the National Consumer Credit Protection Act (NCCP), MFAA's procedural requirements, the requirements of their aggregator/broking group and the lender's own requirements. We argue that a broker loan is subject to more checks than one from the proprietary channel.

Under the NCCP, brokers are either required to hold an Australian Credit Licence or be a credit representative of an ACL holder. No such requirements apply to an employee of a lender, who is responsible for loans.

Under the NCCP, brokers are required to hold at least Certificate IV qualification – this does not apply to lenders' employees. MFAA members are required to hold a higher Diploma level qualification.

Under the NCCP, brokers are required to carry out a preliminary assessment of the applicant's suitability for finance, before submitting the application to a lender, who then has to carry out the final assessment. In carrying out the preliminary assessment, the broker is required by ASIC to make their own assessment and not rely on lenders' calculators and other material. It is not uncommon for broker to complain that a borrower declined by them because of inappropriateness of finance has been approved for finance by a bank branch.

Furthermore under the MFAA Code of Practice, MFAA Credit Advisers are required to satisfy themselves of the "*appropriateness"* of the loan to the borrower's circumstances, a higher test than *"not unsuitable"* under the NCCP, which proprietary channel lenders are required to meet.

The following note from a new MFAA member attests to the above comments:

> *"As a 30 year banker, and less than 5 months ago making the move to broking, I can absolutely back up the view that third party introduced business should be seen as inherently less risky than bank sourced business.*
>
> *Not only do bankers not have to comply with Cert IV, Diploma, Professional Liability, Industry Association membership and probity including police checks, credit checks and the like, but we also have a wide repertoire of lenders to select an appropriate option for our clients. Think further about bankers with high sales targets and it doesn't take too much to realise that brokers hold a high degree of professional and individual integrity.*
>
> *The level of upfront and trail paid to me is not a determinant in my selection or guidance to a client in selecting an appropriate lender. Conversely, some of the highest paying financiers I avoid as their processes are extremely cumbersome and uncommercial, necessitating in many cases my avoidance of their products. Reputation is everything in our industry and the broad implication that brokers are less trustworthy is absurd."*

THIRD-PARTY (BROKER) ORIGINATED LOANS ARE NOT RISKIER – THE EVIDENCE

Statistics released publicly[3] show that there is no material difference between the quality of broker and proprietary channel loans and on at least one measure broker loans are superior.

- Approval rates for new home loans
  Proprietary Channel: 73%, Broker 70%

- Average arrears
  Proprietary channel: 60-70bps, Broker 70-80bps

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[3] 'The Real Value of Brokers to Banks- Busting the Myths: Jon Flavell, General Manager NAB Broker, MFAA National Convention, May 2012

Note: the proprietary channel arrears are based on older books which gradually improve in arrears over time. If this measure was conducted over the same period as the time period of the mortgage broker book, MFAA asserts that the average arrears rate for brokers would be less than the proprietary channel.

- Conversion rates for new home loans
  Proprietary Channel: 63%, Broker 64%

Further, statistics produced at the MFAA National Convention, May 2014, by RP Data[4] show that while brokers are responsible for 39% of loan applications, they are responsible for close to 50% of settlements.

These following characteristics provided by NAB[5] add to the evidence that broker loans are not riskier:

- Broker loans – higher quality than branch loans
  - Delinquency better or equal to branch loans
  - Average size higher and tenure longer
  - Borrower personal and family income higher

- Broker customers younger
  - 56% under 40 (branch 48%)
  - 57% uni-educated (branch 48%)
  - 74% fulltime employed (branch 65%)

CONCLUSION

MFAA, in general supports the thrust of the Draft Prudential Practise Guide on Residential Mortgage Lending. However we reiterate that the unfortunate characterisation of third-party (broker) loans as a category that is, in itself, riskier is mistaken.

As stated as these loans spread across the range of different types of loans in the market, all with their inherent risk levels, some of them may be more risky than others, but not because of the source of the loan, but because of the nature of the particular category of loan. The same comment can be made about proprietary channel loans.

Accordingly MFAA requests that all references to third party loans as being riskier loans in the Draft Guide be removed.

[4] Tim Lawless presentation to MFAA National Convention, May 2014
[5] Better Business Forums: March 2014,Steve Kane, General Manager NAB Broker