Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry

Some Features of the Australian Mortgage Broking Industry

Background Paper 2

ISBN: 978-1-920838-37-9 (Online)

1. Purpose of the Paper

This background paper provides information about two particular industry participants in the Australian mortgage broking market, mortgage brokers and mortgage aggregators, some features of the Australian mortgage broking industry and the main services provided by mortgage brokers and mortgage aggregators. This paper has been prepared (and charts have been constructed) using public information.

This paper illustrates the following key points:

a) The mortgage broking industry is a key distribution channel for residential mortgage financing in Australia, settling 55.7% of all residential home loans in the September quarter 2017;
b) Mortgage aggregators act as intermediaries between mortgage brokers and lenders, by providing brokers with access to lenders on their aggregator's panel;
c) Residential property investors and residential owner-occupiers are the main customers of mortgage brokers, collectively accounting for over 75% of the customers of mortgage brokers;
d) Banks still finance the majority of the loans originated through mortgage brokers, although there is a modest increase in the volume of loans financed by non-bank lenders;
e) Mortgage brokers and mortgage aggregators do not charge borrowers directly for their services. Instead, they typically receive upfront and trail commissions from the lender.

2. Introduction

For many Australian consumers, purchasing a residential property is one of the most important financial decisions they will make,[1] as it often entails obtaining a residential mortgage loan for a significant amount. The mortgage broking channel in Australia is now a key distribution channel for residential mortgage financing. According to the Mortgage & Finance Association of Australia ('MFAA'), mortgage brokers settled $51.77 billion or 55.7% of all residential home loans in the September quarter 2017.[2]

1 See generally ASIC, *Home loans*, MoneySmart (1 September 2017), <https://www.moneysmart.gov.au/borrowing-and-credit/home-loans>.

2 MFAA, *Broker market share rises to a record 55.7% in September quarter* (19 November 2017), <https://www.mfaa.com.au/news/broker-market-share-rises-to-a-record-55.7-percent-in-september-quarter>.

3. Mortgage Brokers and Mortgage Aggregators

Both the Reserve Bank of Australia ('RBA') and the Australian Securities and Investments Commission ('ASIC') have noted some contributions the mortgage broking industry has made to the Australian home loans market to date. The contributions noted include making it easier for borrowers to compare the costs and features of different loans and contributing to the increase in competition between lenders in the Australian mortgage market.[3]

3.1 Main industry participants

Mortgage brokers act as an intermediary by matching borrowers to lenders (and their loan products), assisting and advising borrowers on the loan application process and negotiating interest rates on home loans.[4]

Mortgage brokers engage in 'credit activities' (which includes giving credit assistance to a consumer)[5] and/or 'acting as an intermediary between a credit provider (i.e. the lender) and a consumer'.[6] Due to this engagement in 'credit activities', mortgage brokers are regulated by ASIC under the *National Consumer Credit Protection Act 2009* (Cth) and must hold an Australian credit licence ('ACL') or be an authorised credit representative of a mortgage aggregator (or any other entity) that holds an ACL.[7]

Mortgage aggregators act between mortgage brokers and lenders by providing mortgage brokers with access to the lenders on its aggregator's 'panel'. Aggregators have contractual arrangements with lenders (these lenders are on the aggregator's panel) which will allow brokers operating under the aggregator to arrange loans from those lenders.[8] This gives mortgage brokers access to a wider range of lenders (as mortgage aggregators can achieve greater economy of scale by aggregating greater volumes of mortgages across different brokers), as well as support services, such as technology infrastructure, marketing and professional training.[9]

---

3 See, e.g., Guy Debelle, 'The State of the Mortgage Market' (Address to Mortgage Innovation Conference, Sydney, 30 March 2010) <https://www.rba.gov.au/speeches/2010/sp-ag-300310.html>; ASIC, *Report 516: Review of mortgage broker remuneration* (March 2017), 8–9, <http://download.asic.gov.au/media/4184768/rep516-published-16-3-2017.pdf>.

4 See ASIC, *Glossary — mortgage broker* <https://www.moneysmart.gov.au/glossary/m/mortgage-broker>; Productivity Commission, *Draft Report: Competition in the Australian Financial System* (January 2018), 215–16 <https://www.pc.gov.au/inquiries/current/financial-system/draft/financial-system-draft.pdf>.

5 ASIC, *Regulatory Guide 203: Do I need a credit licence?* (May 2013), 18–23 <http://download.asic.gov.au/media/1241288/rg203-published-29-may-2013.pdf>.

6 See generally ibid.

7 Ibid 5.

8 See further ASIC, *Report 516*, above n 3, 7.

9 See ASIC, *Report 516*, above n 3, 7–8; Productivity Commission, *Draft Report*, above n 4, 214; MFAA, *MFAA Aggregators, Dealer Groups and Franchise Groups* <https://www.mfaa.com.au/our-industry/mfaa-aggregators-franchise-groups>.

As mortgage aggregators also engage in credit activities by acting as an intermediary,[10] they must hold an ACL. If a mortgage broker operates under the ACL of a mortgage aggregator, then the mortgage aggregator is responsible for the conduct of that broker.[11]

Lenders provide the funds for a home loan.[12] They can be either authorised deposit-taking institutions ('ADIs')[13] or other non-ADI lenders.[14]

Borrowers are persons or entities that incur a debt to a lender on agreed terms.[15] Borrowers can also include consumers seeking refinancing of their existing mortgage loans.

3.2 Changes in the number of mortgage brokers and mortgage aggregators

Detailed publicly available information on changes in the number of mortgage brokers and mortgage aggregators over time is limited. According to the MFAA, there were 16,009 mortgage brokers as at 31 March 2017.[16] This was an increase from the 13,841 mortgage brokers reported as at the end of September 2015.[17]

On the number of total mortgage aggregators operating in Australia, public information does not allow for a comprehensive total figure for a specified year, nor for a given time period to be compiled. However, by way of example, the MFAA has published a list of its 50 aggregator members on its website.[18]

---

10 See further ASIC, *Regulatory Guide 203: Do I need a credit licence?* (May 2013), 24 <http://download.asic.gov.au/media/1241288/rg203-published-29-may-2013.pdf>.

11 See generally *National Consumer Credit Protection Act 2009* (Cth), Part 2-3, Division 4. See also ASIC, *Report 330: Review of licensed credit assistance providers' monitoring and supervision of credit representatives* (March 2013), <http://download.asic.gov.au/media/1344176/rep330-published-13-March-2013.pdf>.

12 See generally Productivity Commission, *Draft Report*, above n 4, 213.

13 See generally Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, *Background Paper 1: Some Features of the Australian Banking Industry* (2018), 19–21 <https://financialservices.royalcommission.gov.au/publications/Documents/some-features-of-the-australian-banking-industry-background-paper-1.pdf>.

14 ASIC, *Report 516*, above n 3, 49.

15 RBA, *Glossary: Borrower*, <http://www.rba.gov.au/glossary/index.html?search=borrower>.

16 MFAA, *Industry Intelligence Service: Exclusive Finance Broker Benchmarking Report* (4th ed), 8 <https://www.mfaa.com.au/sites/default/files/users/user130/IIS.4%20FINAL%201.11.17.pdf>.

17 Ibid.

18 MFAA, *Our industry: MFAA Aggregators & Franchise Groups* (2018) <https://www.mfaa.com.au/our-industry/mfaa-aggregators-franchise-groups>.

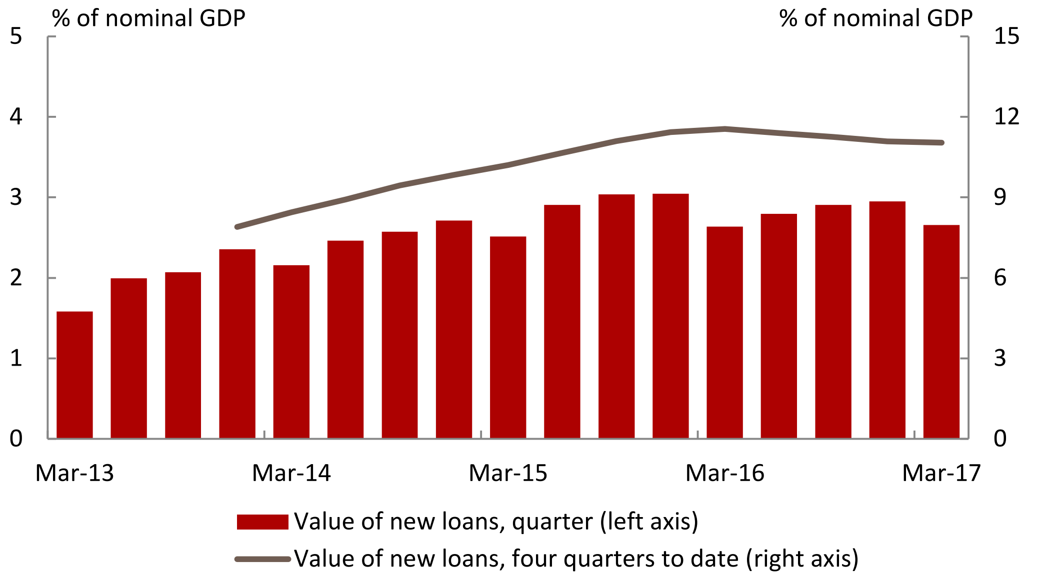
3.3 Industry size and composition

3.3.1 Size of the Australian mortgage broking industry

The size of the Australian mortgage broking industry can be illustrated by a number of measures derived from publicly available information.

According to data from the MFAA and the ABS, the total value of new loans placed by brokers has increased as a percentage of GDP since March 2013 but has remained relatively stable over recent quarters. Loans placed by brokers in the March quarter 2017 was equivalent to around 2.7% of nominal GDP (four quarters to March 2017), up from around 1.6% in the March quarter 2013.[19] In the four quarters to March 2017, the value of the loans placed by brokers was equivalent to around 11% of nominal GDP.[20]

Chart 1: Value of new loans placed by brokers, % of GDP



Source: *MFAA[21] and ABS[22]*

According to data from the MFAA, the value of new loans placed by brokers has increased as a percentage of new residential home loans. Loans placed by brokers have increased from around 44% of new residential home loans in the December quarter 2012 to 53.6% of new residential home loans in the March quarter 2017, an increase of almost 10 percentage points over this time period.[23]

---

19 MFAA, above n 16, 14 and Australian Bureau of Statistics ('ABS'), *5206.0 – Australian National Accounts: National Income, Expenditure and Product, Sep 2017* (6 December 2017) <http://www.abs.gov.au/ausstats/abs@.nsf/mf/5206.0>, (Table 1 Key National Accounts Aggregates, Gross Domestic Product, current prices, original, four quarters to March 2017).

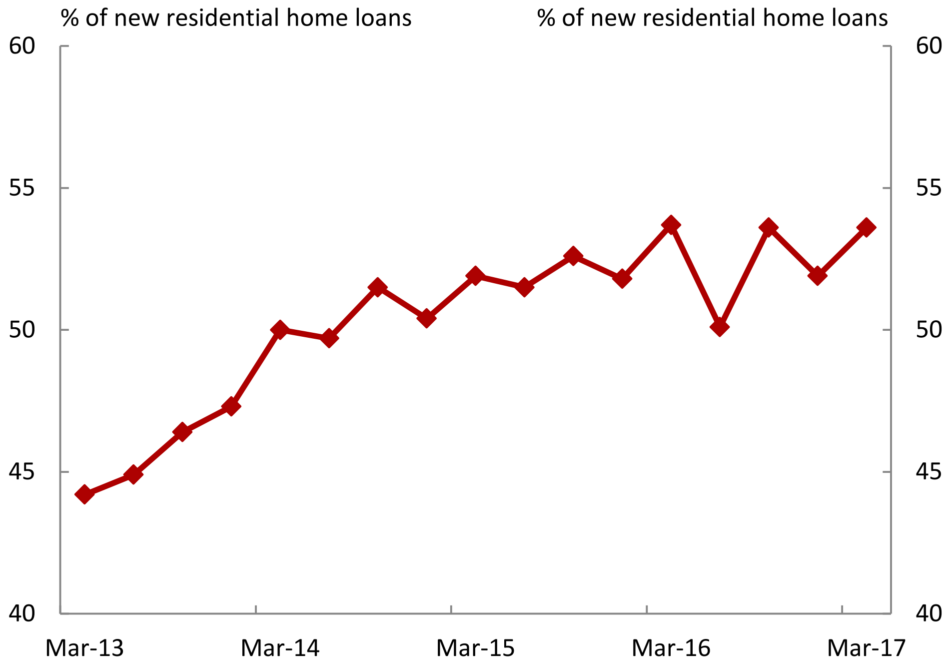
20 Ibid.

21 MFAA, above n 16, 14.

22 ABS, above n 20.

23 MFAA, above n 16, 15.

Chart 2: Value of new loans placed by brokers, % of new residential home loans



Source: *MFAA*[24]

Another measure of the size of the Australian mortgage broking industry is annual revenue. A report by EY (commissioned by the MFAA) observed that the mortgage broking industry (as measured by annual revenue) grew by 10% in 2014–15 after a contraction in growth from 2009 to 2012. The report noted, however, that this growth is expected to plateau as brokers shift their focus from acquiring customers to servicing existing customers, which some lenders believe could also lead to a consolidation in the number of mortgage brokers.[25]

3.3.2 Business structures

For mortgage brokers, public information indicates that the Australian mortgage broking industry comprises a majority of brokers working in small offices of one or two mortgage brokers. The MFAA (based on its sample of 5,371 brokers from 16,009 brokers) provided a figure of 56% of mortgage brokers working in such small offices in the six month period from October 2016 to March 2017.[26] Some of the larger brokers also operate through a

---

24 Ibid.

25 EY, *Observations on the value of mortgage broking: Prepared for the Mortgage & Finance Association of Australia* (May 2015), 5 <https://www.mfaa.com.au/sites/default/files/users/user133/150331%20E%26Y%20Report%20-%20Observations%20on%20the%20Value%20of%20Mortgage%20Broking_MFAA_Broker_final.pdf>.

26 MFAA, above n 16, 30.

franchise network,[27] although there is no public information on the aggregate number of brokers operating under a franchise.

While there is no public information on the total number of mortgage aggregators owned by ADI lenders, the Productivity Commission has recently published the following overview of the aggregators owned by lenders:

- Commonwealth Bank of Australia owns 100% of Aussie Home Loans and 20% of Mortgage Choice;
- National Australia Bank owns 100% of Choice, Finance & Systems Technology Pty Ltd (FAST) and Professional Lenders Association Network of Australia Pty Limited (PLAN); and
- Macquarie holds minority stakes in Connective, Vow Financial and Yellow Brick Road.[28]

The Productivity Commission also estimated that 'the combined market share of these aggregators was just under 70% as at December 2015'.[29]

3.3.3 Comparative size of different types of mortgage brokers as a proportion of the industry

The mortgage broker industry is made up of wholesale aggregators and retail franchises — some larger brokers operate through a national network of franchises. As at March 2016 (latest data available), 83% of brokers were aligned to aggregators and 17% were aligned to retail franchise networks.[30]

The Adviser, a media platform for Australia's mortgage and finance brokers, publishes an annual ranking of the 'Top 25 Brokerages'. The rankings are decided by scores in five key areas: total book size, total loans settled in the referenced year, volume of loans settled in the referenced year, book size versus years in business and average broker volumes for the referenced year.

Data from *The Adviser*'s 2017 rankings (based on metrics for financial year 2016) are consistent with the MFAA's 2016 data. Of the top 25 brokerages in 2017, four (16%) were franchises, one was a hybrid (presented as being both franchise and non-franchise) and the remaining twenty brokerages (80%) were non-franchise operations.[31]

---

27 See, e.g., James Mitchell, 'Top 25 Brokerages 2017', *The Adviser* (16 August 2017), <https://www.theadviser.com.au/features/rankings/36626-top-25-brokerages-2017>.

28 Productivity Commission, *Draft Report*, above n 4, 214.

29 Ibid.

30 MFAA, *Industry Intelligence Service: Exclusive Finance Broker Benchmarking Report* (2nd ed), 8 <https://www.mfaa.com.au/sites/default/files/users/user151/MFAA%20IIS%20Oct%202015%20-%20Mar%202016.pdf>.

31 Percentages calculated from James Mitchell, 'Top 25 Brokerages 2017', *The Adviser*: ibid.

According to data provided by *The Adviser* on the top 25 brokers, four brokers — Aussie, Mortgage Choice, Loan Market and Smartline Personal Mortgage Advisers — are larger in terms of total book size, volume of loans settled and number of brokers. The remaining brokers in *The Adviser*'s top 25 have a smaller share of the market.[32]

Chart 3: *The Adviser* Top 25 brokerages, total loan book, financial year 2016

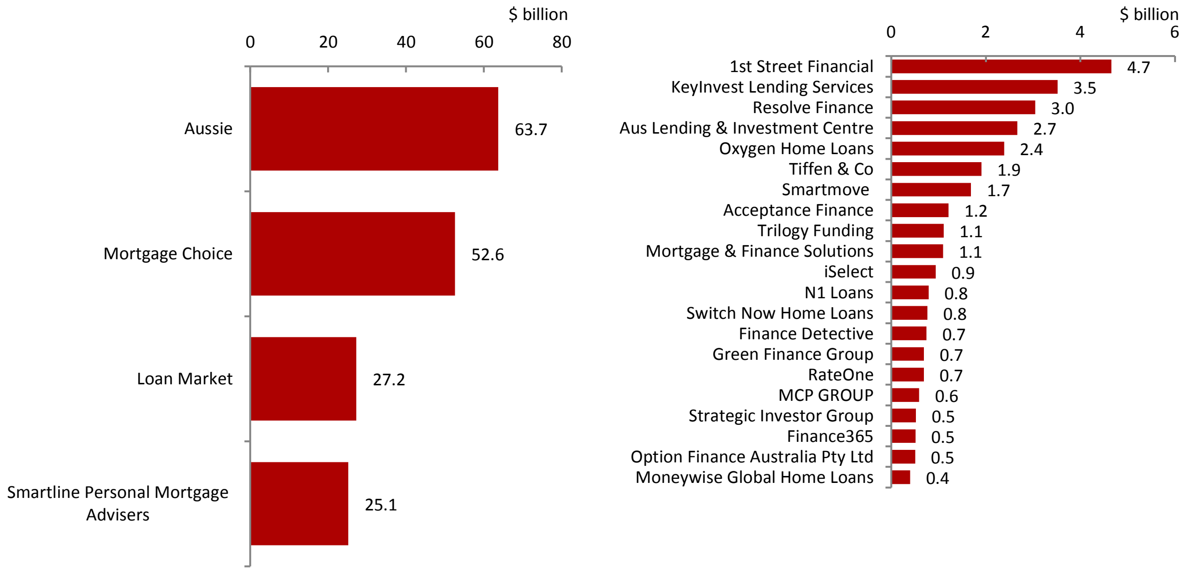
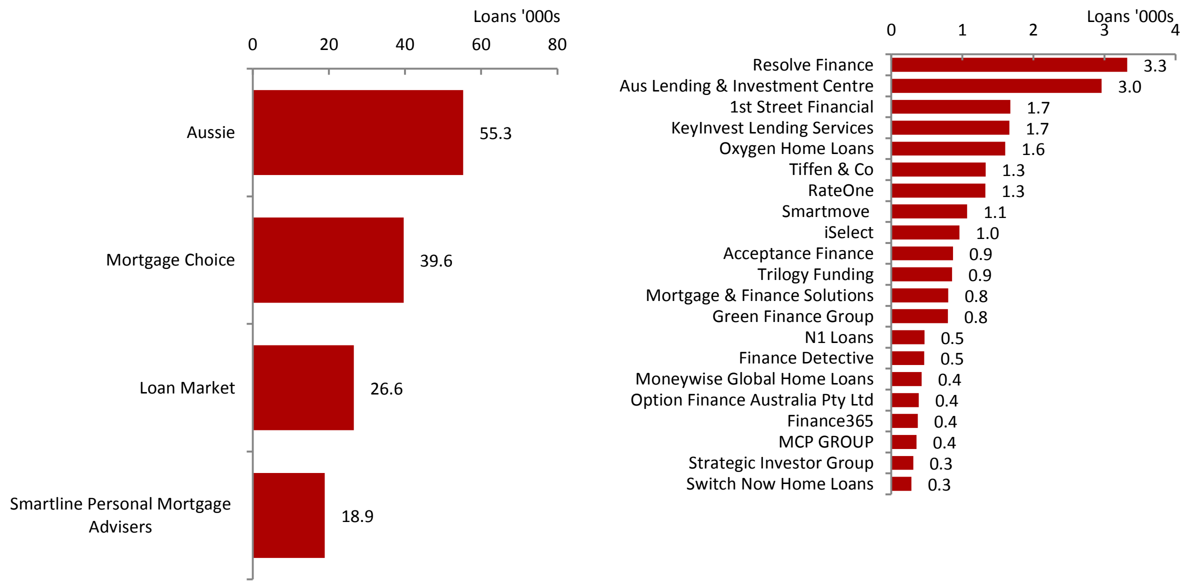
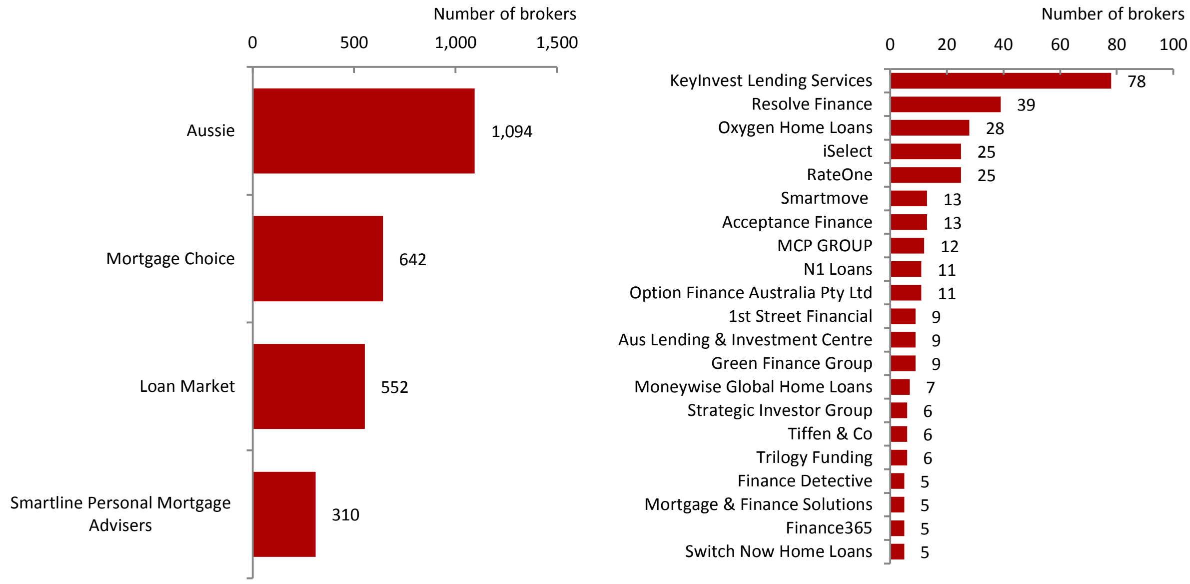


Chart 4: *The Adviser* Top 25 brokerages, loans settled, financial year 2016



32 Data calculated from James Mitchell, 'Top 25 Brokerages 2017', *The Adviser*: ibid.

Chart 5: *The Adviser* Top 25 brokerages, number of brokers, financial year 2016



Source: *The Adviser*[33]

In financial year 2016, the average loan size of *The Adviser*'s top 25 brokerages ranged from around $235,000 to around $719,000, while the number of loans per broker ranged from around 21 to around 329 loans. The larger brokers in the top 25 had lower average loan sizes and loans settled per broker than others in the top 25.[34]

Chart 6: *The Adviser* Top 25 brokerages, average loan size, financial year 2016

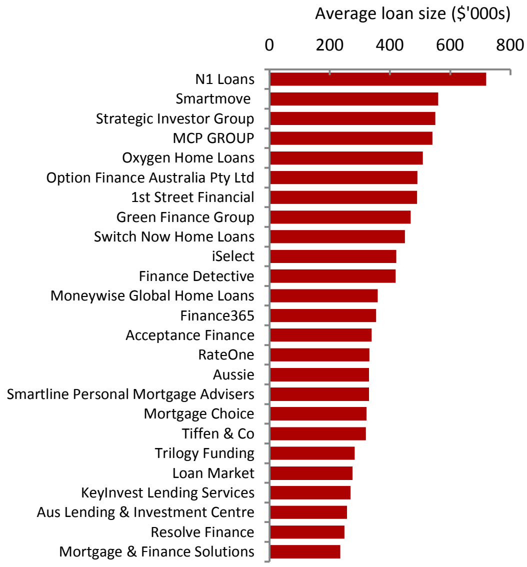
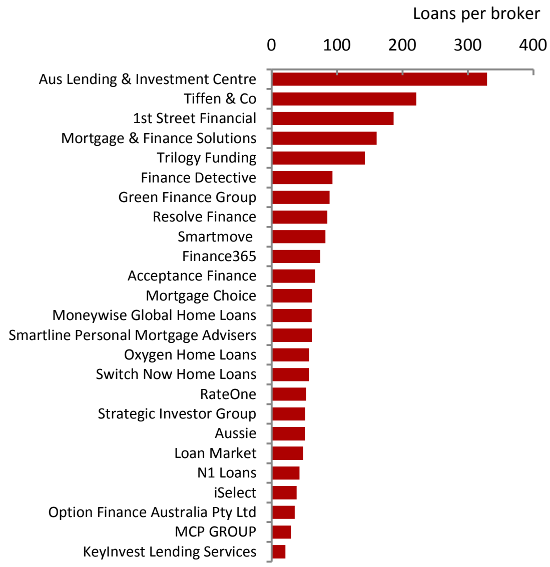


Chart 7: *The Adviser* Top 25 brokerages, number of loans per broker, financial year 2016



Source: *The Adviser*[35]

33 Data calculated from James Mitchell, 'Top 25 Brokerages 2017', *The Adviser*: ibid.
34 Data calculated from James Mitchell, 'Top 25 Brokerages 2017', *The Adviser*: ibid.
35 Data calculated from James Mitchell, 'Top 25 Brokerages 2017', *The Adviser*: ibid.

3.3.4 Number of mortgage brokers that are credit representatives

Mortgage brokers can operate as an authorised credit representative of a mortgage aggregator (or other entity) with an ACL, instead of directly holding an ACL themselves.[36]

According to the most recent public information from ASIC regarding its budgeted industry levies for the deposit taking and credit sector, there are a total of 4,861 credit intermediaries with 36,149 credit representatives for the year 2017–18.[37] Despite some further detailed information on credit representatives made publicly available by ASIC,[38] it is not possible to determine the corresponding figures specifically for the mortgage broking industry. For illustration, Mortgage Choice Limited, a large national franchise of mortgage brokers, has publicly reported having 654 loan writers, including limited credit representatives.[39]

---

36 See n 7 and accompanying text.

37 ASIC, *Cost Recovery Implementation Statement: Levies for ASIC Industry Funding (2017–18)* (October 2017), 47 < http://download.asic.gov.au/media/4506901/cris-levies-for-asic-industry-funding-2017-18-published-6-october-2017.pdf>.

38 See Australian Government, *ASIC — Credit Representative Dataset* (1 February 2018), <https://data.gov.au/dataset/asic-credit-representative>.

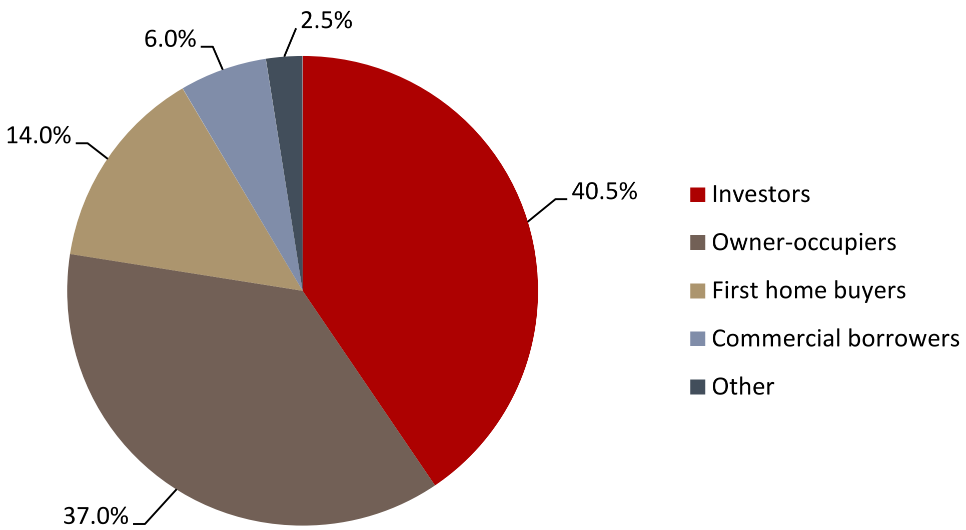
39 Mortgage Choice Limited, *2017 Annual Report*, 13 <https://www.mortgagechoice.com.au/media/1836/mortgage-choice-annual-report-2017.pdf>.

4. Consumer Interaction with the Mortgage Broking Industry

4.1 Types of customers that use mortgage brokers

A report prepared by EY in 2015 sets out information on the types of customers that use mortgage brokers (as classified by the type of loan originated through the mortgage broking channel).[40] This information is presented in Chart 8 below. It shows that residential property investors and residential owner-occupiers make up over 75% of the customers of mortgage brokers.

Chart 8: Types of customers that use mortgage brokers



Source: *EY*[41]

All the categories above may include borrowers seeking to refinance their existing mortgages.

4.2 Some characteristics of the loans arranged through the mortgage broking channel

4.2.1 Average loan size and loan-to-valuation ratios of loans placed by brokers

There is limited public information on the characteristics of loans arranged through the mortgage broking channel. The content for this sub-section 4.2.1 is provided for illustrative purposes only — given the data has been drawn from a limited sample, caution should be

40 EY, above n 25, 7.

41 Ibid.

taken in drawing any conclusions (for example, on the comparative credit quality of mortgage broker originated loans).

A review conducted by ASIC found that loans obtained through the mortgage broking channel (as sampled in 2012 and 2015) were 'on average larger' in dollar terms and had a 'higher loan-to-valuation ratio' ('LVR') — typically between one and four percent — than loans originated directly from lenders.[42]

These findings were broadly consistent with some observations made by EY, which included statements that the 'average loan size of a broker originated mortgage is higher than direct' lending and that although mortgage broker originated loans had higher average LVRs, this may be explained by the higher proportion of investor borrowers seeking loans through brokers.[43]

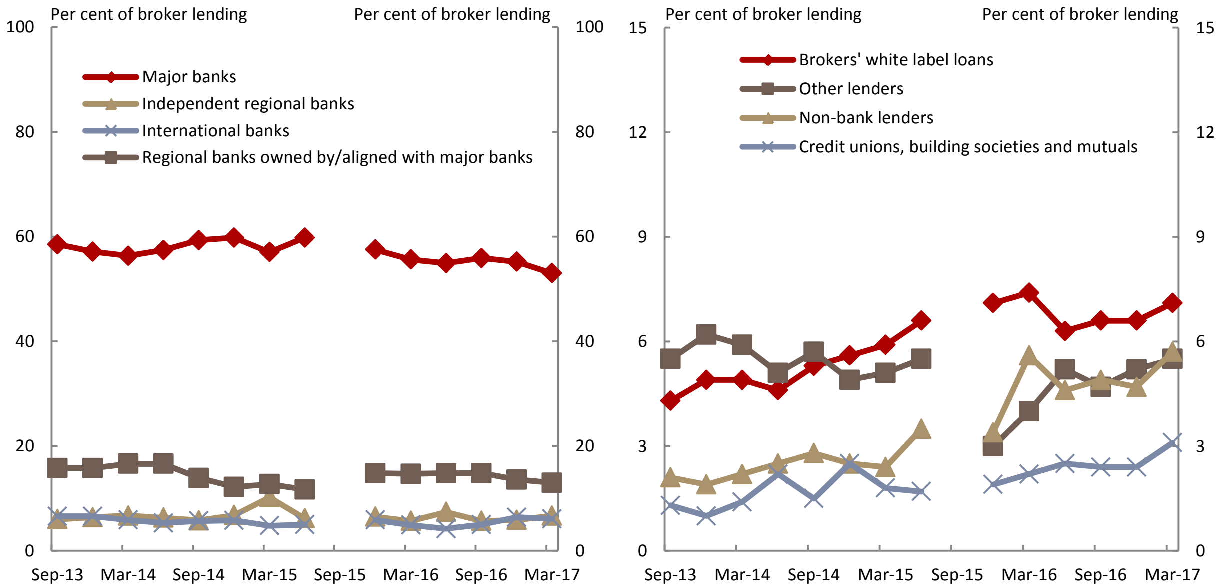
4.2.2 Lender shares of loans placed by mortgage brokers

Data from the MFAA, reconstructed in Chart 9 below, show that the composition of lending placed by brokers is shifting slightly. There has been an increasing trend in lending placed by brokers from non-bank segments, albeit from a lower base. There has been a noticeable increase in loans from non-bank lenders and other lenders, with some increase in brokers' white label loans (loan packages only available through the broker channel) and credit unions, building societies and mutuals.

The proportion of loans placed by brokers originating from the major banks and regional banks owned or aligned with major banks has declined (from 74.3% in in the three months to September 2013 to 66.0% in the three months to March 2017). However, these loans still make up the majority of loans placed by brokers.[44]

42 ASIC, *Report 516*, above n 3, 10, 14.
43 EY, above n 25, 8.
44 MFAA, above n 16, 18.

Chart 9: Share of broker originated loans, by type of lender



Source: *MFAA*[45]

4.3 Commissions

Generally, mortgage brokers and mortgage aggregators do not charge borrowers directly for their services. Instead, most brokers' income is derived from commissions. The two main types of commissions are upfront and trail commissions.[46] According to ASIC, there is a standard industry practice for commission payments to be paid by the lender to the mortgage aggregator in the first instance, which then retains a portion, passing on the balance to the mortgage broker(s).[47] This standard practice is also set out diagrammatically in Figures 1 to 4 below.

Again, there is only limited public information on the value of commissions paid to mortgage aggregators and mortgage brokers by lenders. The Productivity Commission has observed that information on commissions paid by (ADI) lenders over time appears 'to be a black box for this industry'.[48] The caution outlined in section 4.2.1 is therefore repeated here. The information provided in this section is again only for illustrative purposes.

---

45 MFAA, above n 16, 18. Data are unavailable for the three months to September 2015.

46 ASIC, *Report 516*, above n 3, 75.

47 Ibid 76.

48 Productivity Commission, *Draft Report*, above n 4, 221.

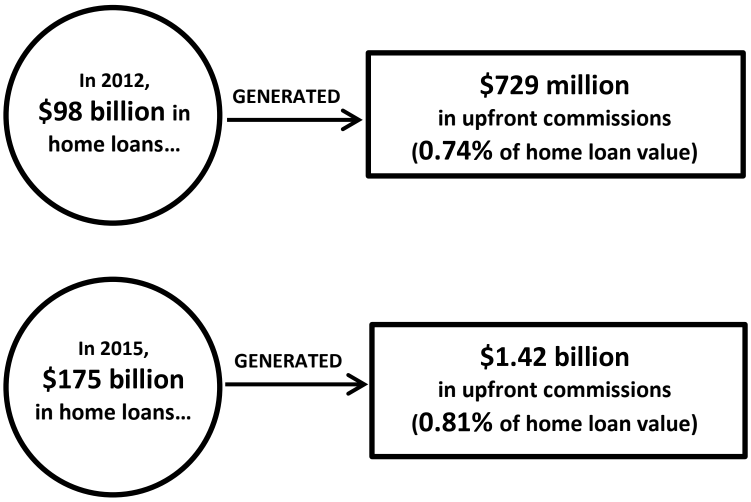
4.3.1 Upfront commissions

The first main form of commission paid by lenders is an upfront commission. This is an initial commission which is generally a once off payment after settlement and based on a proportion of the settled amount, drawn amount or the approved limit.[49]

Based on unpublished industry data, the Productivity Commission has charted the average upfront commission rates paid by lenders for the years 2002, 2007, 2012 and 2017,[50] which supported its observation that 'broker commission rates are currently slightly lower than prior to 2007'.[51]

According to the review conducted by ASIC, lenders paid approximately $1.42 billion in upfront commissions on $175 billion of home loans in 2015 (0.81% of home loans) and $729 million on $98 billion of home loans in 2012 (0.74% of home loans), representing an increase in commissions as a percentage of home loans between these years.[52]

Figure 1: Upfront commissions received by brokers (based on sample), 2012 and 2015



Source: *ASIC*[53]

In 2015, the average rate of upfront commission (based on data received by ASIC from their reviewed aggregators) paid by lenders to aggregators was 0.62%, and the average rate of upfront commission passed on by aggregators to broker businesses was 0.54%.[54]

---

49 ASIC, *Report 516*, above n 3, 241.

50 See Productivity Commission, *Draft Report*, above n 4, 222 (Figure 8.4).

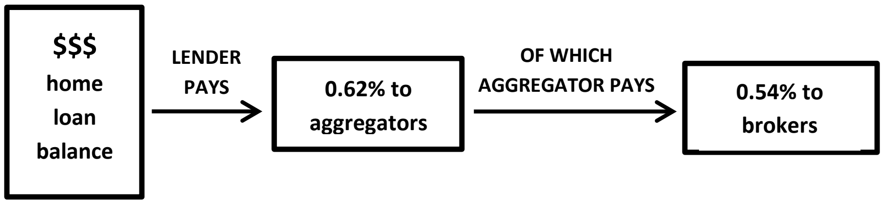
51 Productivity Commission, *Draft Report*, above n 4, 221.

52 ASIC, *Report 516*, above n 3, 9.

53 Ibid.

54 Ibid 76.

Figure 2: Average pass-through of upfront commissions from aggregators to brokers (based on sample), 2015



Source: *ASIC*[55]

The MFAA has also published information for the more recent period of October 2016-March 2017, providing a figure of an estimated average gross upfront commission of $76,827 per broker per annum (prior to costs).[56]

4.3.2 Trail commissions

The second main form of commission paid by lenders is a trail commission. This is a regularly recurring commission based on a proportion of the current or average loan balance.[57]

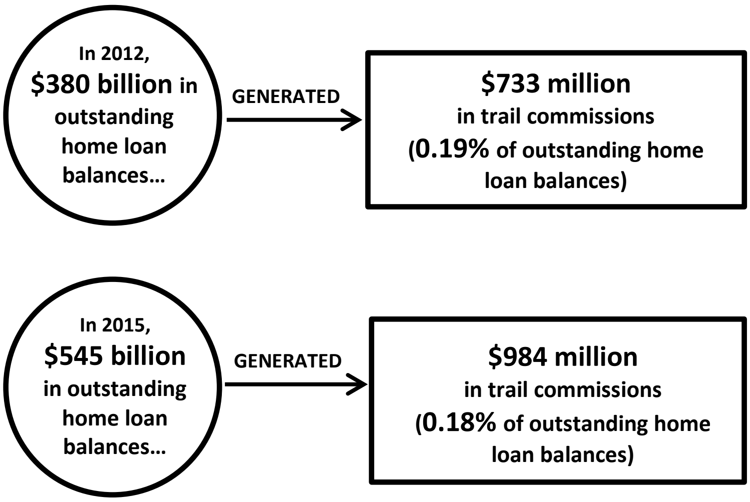
In its January 2018 draft report, the Productivity Commission did not present any findings based on unpublished industry data, as it did for upfront commissions.

According to the review conducted by ASIC, lenders paid approximately $984 million in trail commissions on an average outstanding balance of $545 billion of home loans in 2015 (0.18% of average outstanding balance) and $733 million on an average outstanding balance of $380 billion of home loans in 2012 (0.19% of average outstanding balance), representing a slight decrease in trail commissions as a percentage of outstanding balances between these years.[58]

---

55 Ibid 76.
56 MFAA, above n 16, 33.
57 ASIC, *Report 516*, above n 3, 241.
58 ASIC, *Report 516*, above n 3, 9.

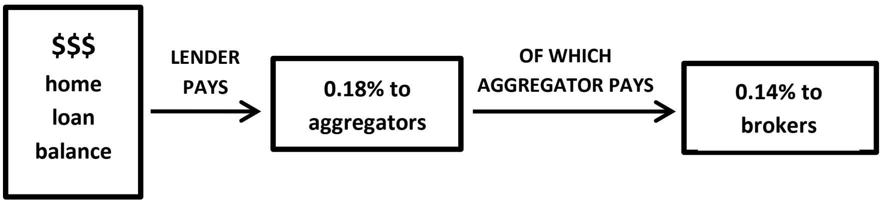
Figure 3: Trail commissions received by brokers (based on sample), 2012 and 2015



Source: *ASIC*[59]

In 2015, the annual rate of trail commission (based on data received by ASIC from their reviewed aggregators) paid by lenders to aggregators was 0.18%, and the annual rate of trail commission passed on by aggregators to broker businesses was 0.14%.[60]

Figure 4: Pass-through of annual rate of trail commissions from aggregators to brokers (based on sample), 2015



Source: *ASIC*[61]

The MFAA has also published information for the more recent period of October 2016-March 2017, providing a figure of an estimated average gross trail commission of $56,579 per broker per annum (prior to costs).[62]

59 ASIC, *Report 516*, above n 3, 9.
60 Ibid 76.
61 Ibid 76.
62 MFAA, above n 16, 34.