DON'T HATE THE PLAYER – HATE THE GAME

A White Paper by Craig Morgan, Managing Director of Independent Mortgage Planners Pty Ltd

Important: Before acting in reliance on this information or copying or linking to it - please see the Disclaimer and Copyright Notice at the end of this Paper.

INTRODUCTION

You won't have to Google too long to find negative press about Mortgage Brokers along with the inevitable rebuttals from the Industry Associations and large Broker Groups. Like most things in life the truth probably sits somewhere in between these polarised viewpoints.

Ignoring for a moment the 'horror stories' and the rogues - which affect every industry in one way or another - to the untrained observer it appears that the majority of Mortgage Brokers do their best to serve their Clients in a professional manner. They certainly appear to believe that they are working in their Client's best interests and they put forth a mass of marketing material along those lines.

But unfortunately in the vast majority of cases they are not assisting their Clients to reduce borrowing costs or remove debt anywhere near as much as they could be.

Now before I offend anyone – read the Title – *"Don't Hate the Player - Hate the Game".*

Your Broker or Banker is most likely a decent human being doing the best they know how with the resources at their disposal – and therein lies the problem.

The Big Guys make sure that the frontline Players are fed information on a need to know basis and that they only have access to the tools and knowledge the Big Guys want them to have.

Now to be very clear here when I say "the Big Guys" I mean the Big Banks and large Broker Groups that are owned, controlled, or heavily influenced by the Banks along with any other large Corporate beast whose snout is so far buried in the commission trough that they cannot and will not pull it back out.

The only time this ever changes is when the Government forces the issue via legislation – just like we are seeing right now in Financial Planning.

For anyone who's paid any sort of attention at all you will know that these sweeping changes – including forcing Financial Planners to act "in the best interests of their Clients" and banning them from "conflicted remuneration" – only came about after some significantly poor outcomes for consumers. For example; Storm Financial, Trio & Astarra, Prime Trust, Westpoint, to name but a few.

IT'S IMPORTANT TO MAKE DECISIONS BASED ON FACT

Fact 1 – Your Banker is NOT Independent

This should be fairly obvious. Your Banker is an employee of an institution that must, by law, put the returns to Shareholders above pretty much everything else - other than breaking the law (and even then it seems to be a bit of a 'game' to see how far they can push it).

Your Banker can only present solutions that suit their employer's products. Additionally most Bank employees are under intense pressure to meet sales targets. The FSU (Finance Sector Union) has said "the pressure on finance workers to meet sales targets is unrelenting, unhealthy and unsustainable"[1].

No matter how nice a person they are - your Banker is not employed to act in your best interests and they are not currently required by law to do so. They are a small cog in a very large machine. As already stated that machine has a vested interest in making money for Shareholders.

Therefore, if your best interests and Shareholders' best interests are ever in conflict (and they almost certainly will be) then you lose - **every time.** As a very simple example – there is no way a Loans Officer will send you to a competing Bank even if they know that you'd be better off.

Fact 2 – It's almost certain that Your Broker is NOT Independent Either

With very, very few exceptions your Mortgage Broker is not independent either[2]. It's true that they aren't employed by one Lender like the Banker and therefore have a wider choice of product solutions. But they face the following challenges:

1. They are still effectively working for the Lender. Not convinced? The Lender pays them commission. Last time I checked the person who pays me is the one I'm working for. So if the Broker is offering you a free service and still claiming to be working for you (and in your best interests) - think again.

2. Of course if they're charging you a fee **and** still keeping the commissions there's a word for that - **GREED**. But the point is they clearly aren't working solely in your best interests. **Note:** - in other industries (e.g. Real Estate) it is illegal to be remunerated by both the vendor and the purchaser. No such prohibition exists in mortgage broking but at least we now have laws stopping claims of independence[3].

---

[1] FSU website at http://www.fsunion.org.au/News-Views/Online-Forum/Are-you-under-pressure-to.aspx

[2] The only exceptions to these comments regarding Mortgage Brokers are the very few pro consumer Brokers (less than 5 small companies in the whole of Australia that I'm aware of) who rebate **100%** of all commission entitlements back to their Clients or who simply don't receive commissions at all (aka Borrowers Agents).

[3] Note that from 1st March 2013 laws have been introduced to stop Brokers using words like independent, impartial or unbiased (unless they actually are). But you can rest assured the clever lawyers and marketing people ('spin doctors') will do their best to find loopholes and coin some new phrases.

3. The majority of Mortgage Brokers are Credit Representatives of large Licensees. In turn most of the large Credit Licences are owned or influenced by the Banks or bank owned subsidiaries. Almost all Mortgage Brokers aggregate via (that is access Lenders via) large entities (Aggregators) owned or influenced by the Banks. See Fact 3 below for more information.

4. Your Mortgage Broker almost always gets paid more if you are borrowing more and therefore has a vested interest in you taking on higher levels of debt.

5. Your Mortgage Broker can earn a new upfront commission (several thousands of dollars on the average sized mortgage) every 2 to 3 years without losing any of their previous commission and therefore has a vested interest in 'churning' your loan every 3 years or so - whether it's in your best interests or not. A refinance to get a slightly lower rate (and a new 30 year mortgage term) is rarely, if ever, in your best interests.

6. Your Mortgage Broker gets paid trailing commission based on the outstanding balance of your loan and therefore has a vested interest in your debt levels staying as high as possible for as long as possible.

7. Trailing commission is paid for the life of the loan (up to 30 years) even though your Mortgage Broker only writes the loan once and may not even have spoken to you since.

Important Note: - from 1st March 2013 if your Broker claims to be independent (or any term meaning the same thing) get it in writing. If they don't meet the requirements to make that claim you should make a complaint to ASIC and/or the Broker's Licensee and Industry Association.

Fact 3 - The Mortgage Industry is largely owned & influenced by the Big Banks

The vast majority of Mortgage Brokers can't access Lenders directly. This is simply because they don't have high enough loan volumes for the larger Lenders to be willing to enter into what are known as 'Head Agreements' with them. Therefore most Mortgage Brokers access most Lenders via entities known as Aggregators (because they 'aggregate' the volumes of many hundreds or even thousands of Brokers).

But even though they don't have agreements directly with the Lender the Big Banks have enough clout that they also insist each individual Broker is separately accredited with them. In some cases this also involves specific **individual** volume requirements or other performance measures that can affect the Broker's commission.

The practical upshot is that before the Broker even begins to think about your needs they must march to the beat of the Lender's drum and also their Aggregator's. In many cases that Aggregator is also the Broker's Credit Licensee - so it's both a commission carrot and a compliance stick.

Just to make things a little more convoluted and conflicted - almost every Aggregator of any size or scale in Australia is owned, either in part or in full, or heavily influenced by the Major Banks[4]. Those that aren't yet owned by them tend to be almost continuously in sales discussions either directly with a Bank or with a larger Aggregator that has Bank ownership (although for strategic reasons most would deny these discussions are taking place). Regardless the Banks have the deeper pockets and definitely have the upper hand in the relationship.

[4] For more information regarding the levels of ownership and influence of Mortgage Broking groups by the Big Banks refer to our separate White Paper – *Who Owns Australia's Mortgage Brokers*

Fact 4 – Your Broker Does NOT Have Access to all Lenders

One of the most enduring claims by Mortgage Brokers is that they have "access to all of the loans and Lenders in the marketplace" or that they "shop around all of the Lenders so you don't have to".

While it is absolutely true that a good Mortgage Broker can save you a lot of time and stress – and generally has a better chance of wading through the various Lenders' marketing hype – the simple reality is that the vast majority of Brokers are only accredited with around 15 or less Lenders (a minority of all Lenders in Australia).

Additionally, the Aggregators I mentioned earlier limit which Lenders they place on their panel – i.e. they control which Lenders the Broker has access to. Not surprisingly they favour the Lenders who pay the higher commissions.

But probably more important are the findings of Fujitsu Consulting that the average Mortgage Broker only ever accesses loans from 3 to 6 Lenders and many others place most of their business with 3 or fewer Lenders[5]. Why? Simple really - in the final analysis the Broker is a human being and most likely a small business person. This means they are far less interested in what is best for you. They are more interested in what is best for them and efficiencies in their business.

Most importantly they are focussed on where they can most easily place your loan, get their commission, and move on to their next transaction. It is simply too hard and too confusing for most Brokers to be expert across the policies and requirements of 50+ Lenders. So, most find a small number of Lenders (known affectionately as their "favourite 5") and stick with them.

Does this mean you're being swindled – or ripped off blind? I would say that in the vast majority of cases – no it doesn't. But is the Broker acting fundamentally in your best interests? Again – in the overwhelming majority of cases – NO THEY ARE NOT.

Fact 5 – Your Broker almost Certainly Does NOT Access the Cheapest Loans

Mortgage Brokers don't access loans that don't pay commissions. *Don't hate the player* - it's almost certain that you don't work for free either. Therefore, despite all of the marketing hype to the contrary, Mortgage Brokers rarely access the most competitively priced products on behalf of their Clients.

And again, Aggregators DO NOT place Lenders on their panel that don't pay commissions.

Now it doesn't necessarily follow that just because a Lender is paying commissions that the loan will be dearer. Almost all Mortgage Brokers will tell you that you will pay exactly the same interest rate, fees and charges if you approach the Lender directly.

You know what? Most of the time that claim is true.

Oh, but **it's only true** for the loan products that the Broker has access to. Many of the Lenders have other products that you can get from the Lender directly which are just plain cheaper.

[5] Fujitsu Consulting Report on the Australian Mortgage Industry November 2006

Of course there are also more Lenders that don't distribute loans via Brokers than there are that do. Again, it doesn't necessarily follow that just because a Lender **isn't paying commissions** to a Broker that their loans will be cheaper.

But if the Lender isn't paying thousands (in many cases tens of thousands) of dollars in commissions there is a strong probability that they can pass some savings along if they choose to. And if they are trying to engage borrowers by direct (including online) means it's likely that discounting interest rates is one of their key strategies.

Fact 6 – Comparison Rates DO NOT tell the whole story

I think by now it is a generally accepted fact within the mortgage industry that the legislation around compulsory comparison rates (AAPR) has been an abject failure. Without going into a lot of detail the two biggest problems are:

1. The comparisons are required (by law) to be carried out on a scenario that almost no borrower ever requires i.e. $150K loan size over 25 years. Whereas the reality is that the average new mortgage is more like $350K over 30 years. Therefore comparison rates for most loan scenarios are actually quite misleading.

2. There are a range of fees and charges that are **not required** to be included if they are "not ascertainable" or otherwise not listed in the legislation. So, of course, within a few short weeks of the legislation being introduced the Lenders ensured that as many fees as possible were 'unascertainable' and simply renamed or re-engineered others.

After years of misleading information and frustration the Government decided to introduce legislation requiring Key Fact Sheets that include a Personalised Comparison Rate (PCR). This PCR is supposed to ensure that you have one single figure that you can rely on to give you an 'apples to apples' comparison between different Loan Products.

While I would agree that PCR is better than the AAPR in terms of allowing valid comparisons of your specific scenario - I have noticed the following three challenges:

1. The Key Fact Sheet is required to be provided by Lenders and Brokers - but only if you ask. In other words nobody in the industry is in a real rush to educate you in this regard.

2. The Key Fact Sheet **does not** take into account things like Lenders Mortgage Insurance (LMI) which can be very significant for loans above 80% LVR and **varies between Lenders**. So, for any loan above 80% the Total Cost, interest fees and charges and the PCR figures are all incorrect. Kind of defeats the purpose really.

3. Lenders can meet the requirement to provide a Key Fact Sheet by placing a 'tool' on their websites which allows you to enter your loan size and term of loan so that a Key Fact Sheet can be created. While that seems like a very sensible approach in this day and age I have noticed a number of situations where Lenders offer different rates based on Loan to Value Ratio (LVR) or risk profile. If the tool to produce the Key Fact Sheet (and PCR) does not allow inputs to assess LVR or credit risk the PCR produced may be wildly inaccurate for your specific circumstances (i.e. much lower than the rate you would actually be offered).

Fact 7 – Online Comparison Sites are just another version of the same problem

Despite some recent well intentioned, but partially inaccurate, media reports comparison web sites are generally not the solution either. The major things to be aware of are:

1. Many are simply marketing sites that will 'sell' your enquiry off to the highest bidder.

2. Most suffer exactly the same limitations as a Mortgage Broker / Aggregator. That is they are **not independent** because:

    a. They receive commissions or other incentives from Lenders or Brokers.

    b. They **do not** include all the Lenders. Many have a very limited range.

    c. They **do not** include Lenders that don't pay to be on there and/or don't pay commissions.

3. Rankings are generally as much (or more) a product of the advertising spends than of any qualitative assessment of the loan product.

4. Most of the time you end up being mislead by an apparently 'cheaper' option that you can't qualify for or which has a very narrow qualification criteria whereas the real offering to suit your requirements is more expensive.

SO – WHAT'S THE ANSWER?

I'm so glad you asked.

Fairly obviously I would say engage the services of *Independent Mortgage Planners*. But I want to keep this information as generic as possible.

So, let's review the features and capabilities you should look for if you want to utilise independent (or pro consumer) mortgage services. In the following information I'll refer to your service provider using the generic term "Mortgage Adviser":

1. To be independent your Mortgage Adviser (and their Licensee):

    a. Must **not** receive commissions from Lenders **or** must rebate **all** commissions to you. **N.B.** All other things being equal it's much better for you to have commissions rebated off the principal of your home loan rather than worrying about finding a Mortgage Adviser who has no commission entitlements - just so long as you receive **all** of them and they aren't causing any conflict for your Mortgage Adviser; **and**

    b. Must **not** receive any other gifts or inducements from Lenders that are likely to influence their decision making; **and**

    c. Must have unrestricted access to all licensed Credit Providers (Lenders) without influence from any party – including their Aggregator. Clearly this means they must be able to access (and hopefully be willing and able to analyse) Lenders who don't pay commissions along with those who do; **and**

d. Must operate without any conflict of interest arising from their association or relationship with Lenders.

For all of the reasons outlined elsewhere in this White Paper – it is virtually impossible for any Mortgage Broker operating under any of the franchised or large Broker / Aggregator Groups to meet any of these requirements – let alone all of them.

2. They should undertake an analysis of the Total Individual Cost[6] (TIC) of any Products being considered using all available facts and figures and **specific to your unique circumstances.** Their recommendations should be available to you in writing as should a clear explanation of the processes they utilise to reach their recommendation.

3. They should be able to explain to you what measures they have in place to safeguard your ongoing commission rebates (if applicable).

4. They (and their employer / Licensee) should earn the same regardless of which Lender is utilised or how much your loan is for. This avoids conflicts of interest and 'product forcing'.

5. **They should rebate 100% of all commission entitlements on any loans they write.** Beware of the growing number of Mortgage Brokers offering partial rebates or refunds as little more than a marketing exercise (hype). Also note that different Mortgage Advisers and their Licensees or Aggregators may be entitled to differing levels of commissions - so make sure you compare 'apples with apples' via a TIC analysis.

Any Mortgage Adviser who can satisfy you that they meet **ALL** of the above requirements is worth putting on your shortlist as your service provider.

The bad news is that, at the time of writing, the short list of companies that meet these criteria is very short indeed. Please feel free to do your own research though. I'm confident that after you've asked the tough questions you'll be in touch with us.

Thanks for reading. I hope we will be able to earn the opportunity to assist you. But regardless I truly hope you gained some insights that empower you to take decisive and independent action to save tens of thousands of dollars in interest and years off your mortgage.

Please send any comments or questions to **info@indmp.com.au** or call us on **1300 367 602**.

For more information about us or our services please visit **www.indmp.com.au**

Disclaimer: *The information provided above is believed to be correct. Any quoted facts or figures are taken from Public Domain sources or other sources believed to be credible and reliable. This paper was written on the 15th January 2013 and all facts are believed to be correct as at that date. Changes in legislation or industry practices may occur over time. Readers should make their own enquiries to confirm any facts before taking action in reliance on them. Any opinions expressed are those of the author and*

[6] Total Individual Cost (TIC) is the only meaningful way to compare 'apples to apples'. Unlike AAPR or PCR / Key Facts Sheet the TIC is unique to you and your circumstances and will factor in all relevant fees and charges - including LMI - and the effects of any commission rebates. You can then compare what it will cost you **in dollars and cents** to pay off each loan Product being considered.

are not necessarily endorsed by Independent Mortgage Planners Pty Ltd. Everything in this White Paper is General Advice and your personal circumstances have not been taken into account. You should take personal advice from a licensed Credit Assistant before making any decisions to refinance a loan or take on any new debt. It may also be prudent to take financial, taxation or legal advice prior to engaging in any transaction. Craig Morgan and Independent Mortgage Planners Pty Ltd (Australian Credit License Number 421998) are licensed to give Credit Advice only and are not licensed to give financial, taxation or legal advice in any jurisdiction.