CONSUMER ACCESS TO MORTGAGES REPORT

MOMENTUM
INTELLIGENCE

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Introduction

In Australia, consumers have a number of channels they can use to obtain a mortgage. The most significant channels today are via a mortgage broker (broker) or direct with a lender (as known as the proprietary channel), with a minority of consumers using an online lender or bank.

Over the last three decades, demand for loans originated by a broker has risen steadily. Today, 59 per cent of all new residential home loans are written via the mortgage broker channel. (MFAA, 2019)

A broker's service typically includes assessing and comparing loan products, understanding borrowing and serviceability capacity, evaluating lender fees and charges, preparing and completing an application, and seeing the application through approval to settlement. Typically, a process that takes anywhere from four to 20 weeks in its entirety.

Brokers operate as an intermediary between a consumer and a lender. They assist the consumer in finding a suitable mortgage product for their needs. They provide a cost-free service to the consumer via commission paid by the lender upon settlement.

The commission payment is generally split between an 'upfront' single payment and a 'trail' fee that is paid monthly for the life of the loan.

This commission structure reflects the economic value that brokers provide to lenders. It provides lenders with the ability to reduce overheads that would be faced through originating loans via a branch network. This cost-effective distribution channel has played a significant role in opening up the mortgage market to non-bank lenders, regional banks, foreign banks and people-owned banks.

Increased competition created by brokers has forced the biggest lenders to cut their margins over the last three decades resulting in lower rates for the consumer.

During the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, there has been significant focus on mortgage broker remuneration and its impact on consumers. In particular, there have been suggestions that Australians would be better off paying a broker a fee for their service rather than a broker receiving commission from a lender.

This report analyses the third-party mortgage distribution channel in Australia, its role in driving competition and ultimately what value it delivers to consumers.

The objective of the 'Consumer Access to Mortgages report' is to consider consumer satisfaction and the implications for Australian borrowers in any change to the current remuneration structure of mortgage brokers.

There are three major sections to this report:

- Section one explores competition in Australia's mortgage lending market and consumer satisfaction with the broker and proprietary channels.
- Section two analyses the current broker remuneration structure and explores its impacts on consumer outcomes, including consumer sentiments towards the current structure.
- Section three considers the alternative; the economics and implications of a fee-for-service model in mortgage broking.

Key findings

1.
Mortgage brokers create competition in mortgage lending placing downward pressure on interest rates.

	1986	2019
Net interest margins	>5%	~2%
Broker share of market	<10%	59%

2.
Consumers are more satisfied with the mortgage broker channel than the proprietary channel.

96%
of consumers are either satisfied or highly satisfied with their **mortgage broker**

67%
of consumers are either satisfied or highly satisfied with their experience going **directly to a lender**

3.
Commission does not influence a mortgage broker's decision to recommend a lender.

“My broker was very open about what commission he gets with which bank, I am **comfortable that the right loan** was selected for me for **my situation**, and not the one that pays the highest commission

4.
Most consumers are not concerned with the current remuneration structure of mortgage brokers.

79%
of consumers have no concerns with the **current remuneration structure** of mortgage brokers

5.
Consumers are not prepared to pay a fee-for-service.

96.5%
of consumers who currently use or intend to use mortgage brokers would not be willing to pay a fee equivalent to the average upfront broker commission.

Section one:
Consumer outcomes

Section one explores competition in Australia's mortgage lending market and consumer satisfaction with the broker and proprietary channels.

1.1 Mortgage brokers and competition in mortgage lending

Traditionally, the primary source of mortgage customers for lenders has been via retail branch networks. The costs of operating a substantial branch network in Australia is significant.

With the growth of the mortgage broker channel, branch networks have become less of a requirement for lenders to access potential customers. This trend has enabled smaller lenders such as non-major banks, non-bank and specialist lenders to enter the mortgage market.

Over the years, the ability for new competitors to access the market via the mortgage broker channel has forced large retail lenders to review the pricing of their products in order to compete. This downward pressure on margins is evident in an analysis of Australia's major banks' net interest margins from 1986 to 2018.

The mortgage broker channel is estimated to have originated less than 10% in the 1980s in contrast with 59.1% in 2018 (MFAA, 2019).

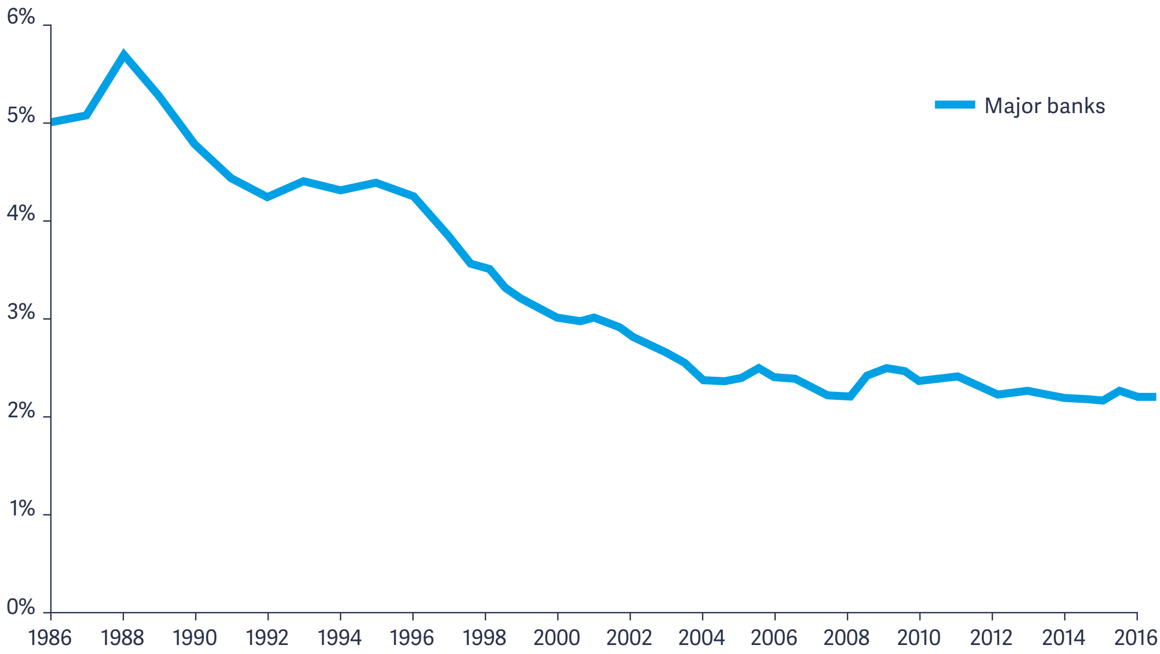
Data from the Reserve Bank of Australia via Deloitte's 'Value of Mortgage broking report' shows that in 1986, the net interest margins of the major banks were in excess of 5%. Over the last three decades, in correlation with the growth of the mortgage broker channel, net interest margins have fallen to approximately 2%.

These competitive pressures are echoed in ASIC's review of mortgage broker remuneration stating:

"[brokers] play a valuable role in providing a distribution channel for lenders — especially smaller lenders — without their own distribution network (e.g. branches) … [and] exert downward pressure on home loan pricing, by forcing lenders to compete more strongly with each other for business".

(*ASIC, 2017*)

Figure 1: Net interest margins of the major banks over time



Source: Reserve Bank of Australia, Bank's Financial Report via Deloitte 'Value of Mortgage Broking Report' (2017)

1.2 Consumer satisfaction with the mortgage broker and proprietary channels

In December 2018, Momentum Intelligence conducted a consumer survey of 5,782 Australian borrowers, titled the 'Borrower experience survey'. The purpose of this survey was to uncover consumer attitudes, perceptions and priorities around their most recent experience in securing a mortgage and to understand how this may affect their future decisions in accessing finance. The key findings from this research are explored in this section and throughout this whitepaper.

Consumers are significantly more satisfied when using mortgage brokers than using the proprietary channel.

Consumers were asked which channel they used to secure their most recent mortgage and how satisfied they were with their experience. Of those surveyed, 96% of respondents who used a mortgage broker were either satisfied or very satisfied, with the majority (84%) stating "very satisfied".

In contrast, only 67% of those who went direct to a lender were either satisfied or very satisfied, of which only 26% were "very satisfied".

Additional consumer research such as FBAA's MyNextAdvice 'Client sentiment' survey (FBAA, 2018) of broker customers found that:

"On average, satisfaction of clients was high with **88%** of respondents indicating that the mortgage broker exceeded their expectations.

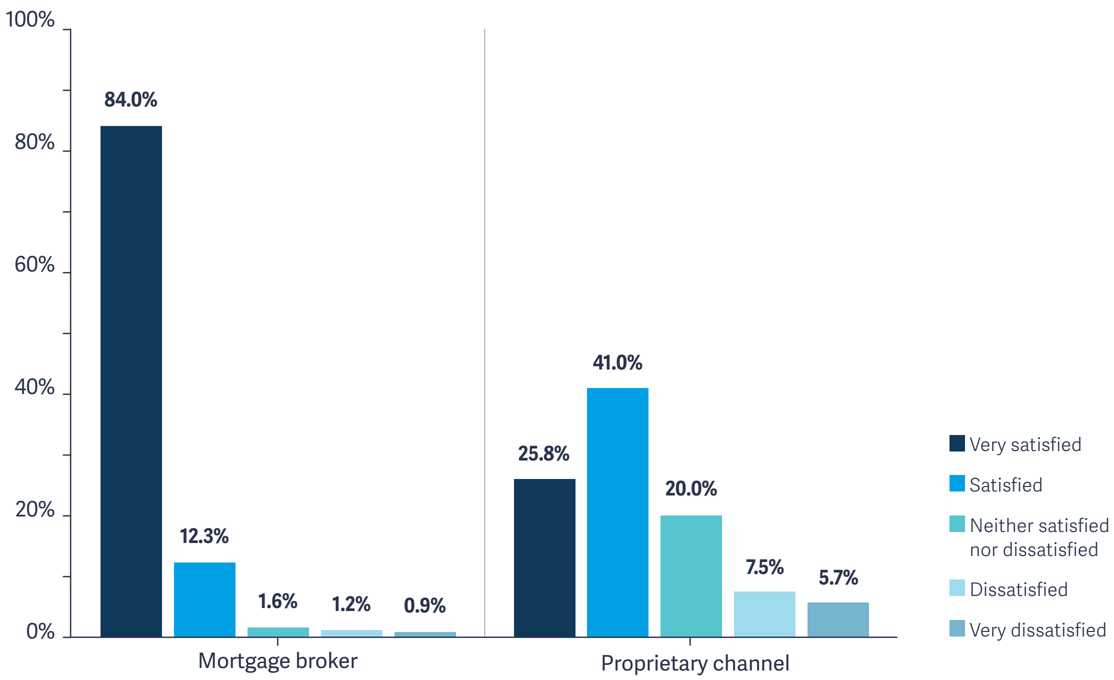
94% were happy with their broker's knowledge and competency.

93% agreed their broker had their client's interest at heart,

93.6% found their broker understood the borrower's needs, objectives and financial situation, and

92.1% were satisfied with the strength of the broker-client relationship."

Figure 2: Levels of consumer satisfaction



Mortgage brokers have extremely high customer retention rates.

Respondents were asked which channel they would choose if they were to take out another mortgage. Close to 96% of consumers who used a mortgage broker in their most recent experience would choose to use a mortgage broker again.

With close to all of satisfied broker customers choosing to use a mortgage broker for their next transaction, the findings of the survey clearly show strong loyalty to this channel.

This high level of customer retention correlates with data released in December 2018 that shows the market share of the mortgage broker channel has reached a new high of 59.1%. (MFAA, 2019)

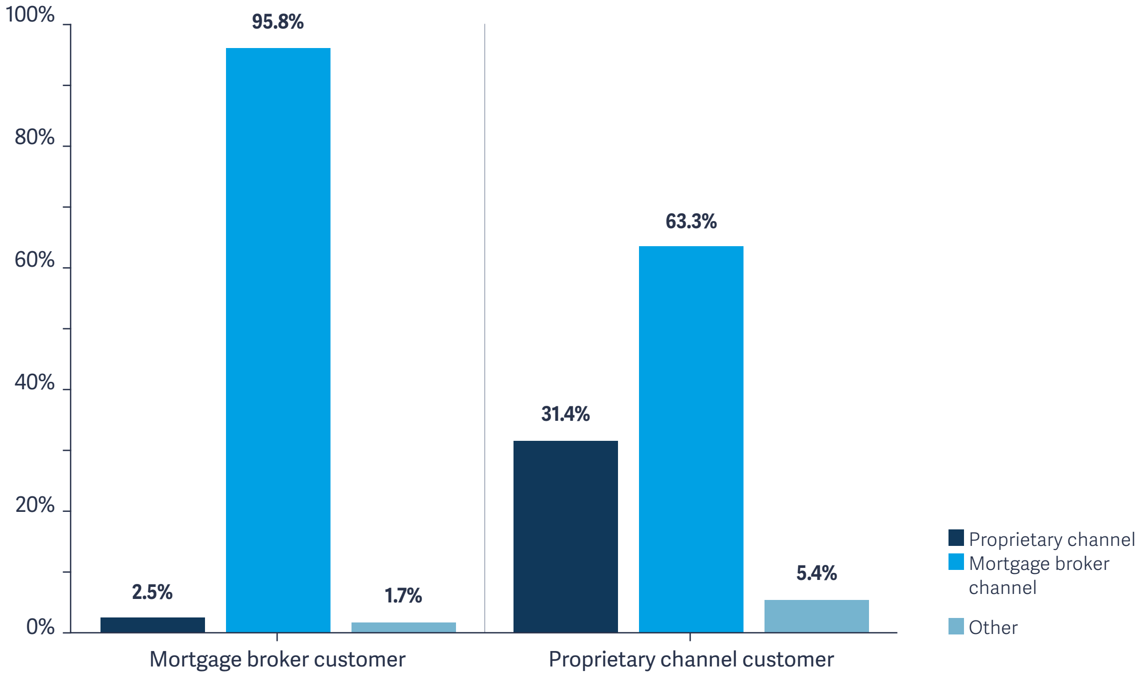
The majority of proprietary channel customers would use a mortgage broker the next time they take out a mortgage.

In contrast with strong channel loyalty in mortgage broker customers, 63% of proprietary channel customers plan to leave this channel and use a mortgage broker to secure their next mortgage.

Only 31% would continue to use the proprietary channel in the future which is reflective of this channel's lower satisfaction rates.

This is a strong indicator that the mortgage broker channel will continue to grow as more Australians choose to switch to the services of a mortgage broker to help them secure property finance in the future.

Figure 3: The channel customers would choose in the future



Consumers choose mortgage brokers because they believe they are most likely to get the best loan for their needs and that they deliver the widest choice of products.

Respondents were able to select multiple options as to why they chose a particular channel.

This gives us insight into some of the important factors that are considered when a consumer goes through the process of choosing a mortgage and the value they place on the support delivered by their provider.

In order of the most selected options, mortgage broker customers selected the channel because:

60% believe they are most likely to get the best loan for their needs

45.8% believe it is the most convenient channel to get their desired outcome

45.4% believe they will get the widest choice of products that are available

26.9% believe they stand the best chance of getting their loan approved

There were similarities in consumer expectations with both channels however mortgage broker customers are generally more confident that they will receive the best loan for their needs.

In order of the most selected options, proprietary channel customers selected the channel because:

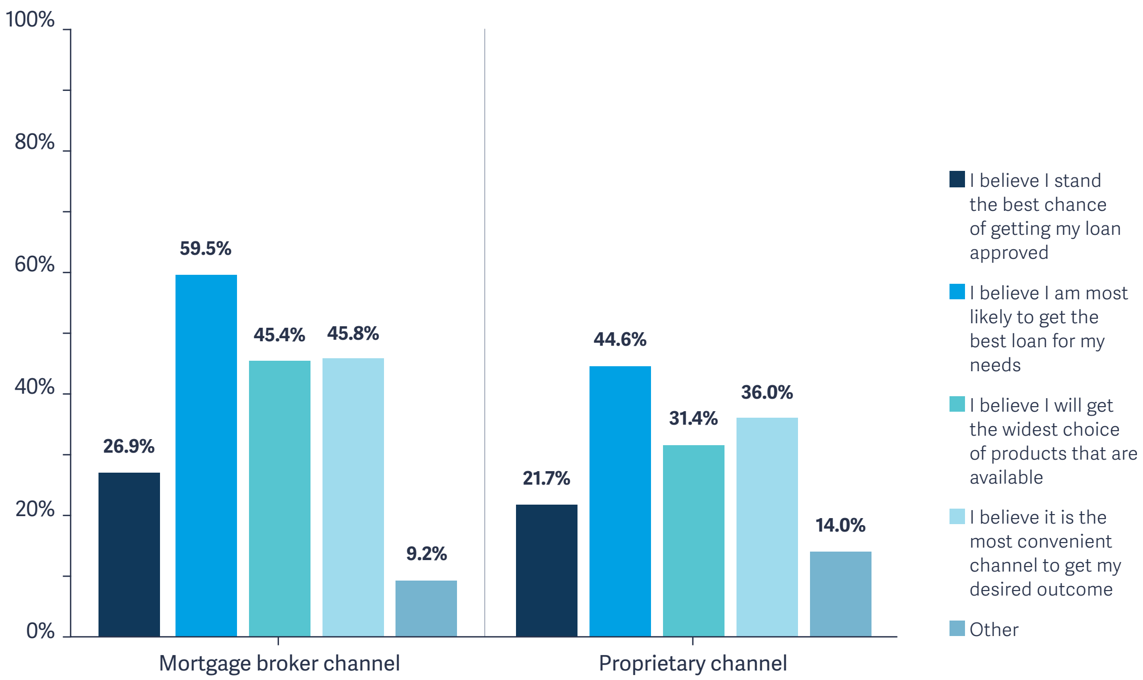
44.6% believe they are most likely to get the best loan for their needs

36.0% believe it is the most convenient channel to get their desired outcome

31.4% believe they will get the widest choice of products that are available

21.7% believe they stand the best chance of getting their loan approved

Figure 4: Consumer reasons for selecting each channel



Section two:
Broker remuneration

Section two analyses the current broker remuneration structure and explores its impacts on consumer outcomes, including consumer sentiments towards the current structure.

2.1 Structure of mortgage broker remuneration

Mortgage brokers are remunerated primarily through a commission model that is linked directly with the loans they settle. Typically, the commission model is made up of two components; an upfront commission and a trail commission.

Mortgage brokers do not usually receive a salary in conjunction with this commission and do not typically charge consumers for their services, however a minority of mortgage brokers may do so.

The upfront commission is usually a percentage of the loan and is paid to the broker when the loan is settled. Trail commission is calculated as a percentage of the outstanding loan balance and is paid over the life of the loan.

This commission structure reflects the work that is undertaken by the mortgage broker to secure a mortgage for their customer. It is also important to consider that with no base salary mortgage brokers are dependent on the commission earned on the loans that they settle. According to Deloitte's 'Value of Mortgage Broking Report', "a single broker working independently as an individual sole trader reported average earnings before tax of $86,417". (Deloitte, 2017)

This commission structure provides lenders with the ability to reduce overheads that would be faced through originating loans via a branch network. This cost-effective distribution channel has played a significant role in opening up the mortgage market to non-bank lenders, regional banks, foreign banks and people-owned banks.

Mortgage broker commission by the numbers

On average

0.54%
Upfront commission (ASIC, 2017)

0.18%
Trail commission (ASIC, 2017)

$371,000
Average owner-occupied loan size

$2,003
Upfront commission

$2,007
Trail commission (over four years)

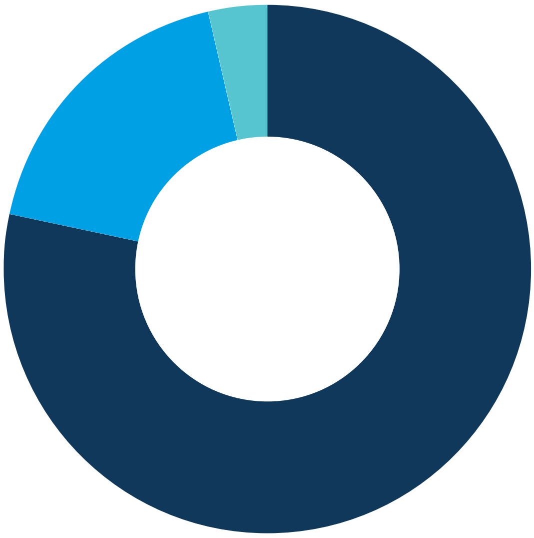
2.2 Consumer sentiments towards mortgage broker remuneration

In understanding the implications of the current commission-based structure on consumer outcomes, it is important to consider the attitudes, perceptions and priorities of Australians borrowers.

Findings from the Borrower Experience Survey indicate that 79% of consumers who have used or intend to use a mortgage broker 'have no concerns' with a commission structure.

This is supported by feedback from a number of respondents, below are a few of these verbatims.The recurring theme is that consumers are highly satisfied with their mortgage broker and do not feel the products recommended have been influenced by the level of commission paid by the lenders.

Figure 5: Consumer sentiments towards mortgage broker remuneration structure



> My broker was very open about what commission he gets with which bank, I am comfortable that the right loan was selected for me for my situation, and not the one that pays the highest commission

> As long as I get the best deal possible, I have no issue in the broker receiving a commission for the work they put in. From my review of the three mortgages I have now placed via a broker, I honestly believe I received the best value for money.

> I have never felt pressed to take a loan or make any decision. The advice and help have been competent, friendly and timely saving me a lot of time and unpleasant experience compared to when I dealt with banks directly.

> Buying a place is expensive enough. Stamp duty alone is absolutely ridiculous and needs to be reformed. I believe it is fairer for the bank/organisation to pay the mortgage broker the commission rather than it be another expense the bank pushes onto the person obtaining the mortgage.

NOTE:
This questionnaire was conducted during the height of the royal commission where mortgage broker remuneration was at the centre of many of the hearings and there is still an overwhelming majority of consumers who have no concerns with this structure.

2.3 Commission and its influence on a mortgage broker's decision to recommend a lender

The findings of the Borrower Experience Survey clearly indicate that the majority of mortgage broker customers are happy with the outcomes they receive from this channel.

Additionally, data from Momentum Intelligence's Third-Party Lending Report supports consumer sentiments around the neglible influence that commission has on which lenders the broker recommends. The Third-Party Lending Reports analyse all facets of how mortgage brokers rate lenders on all areas of their third-party proposition. Results from three years of this in-depth report clearly show that commission structure and remuneration are consistently ranked as two of the least influencing factors of attributes that influence a mortgage broker's decision to recommend a lender.

The factors that are most influential in a broker's choice of lender are product policy, product pricing and turnaround times. Each of these factors are directly related to ensuring the application and lodgement processes are handled efficiently and effectively to maximise the likelihood of the best outcome for the consumer.

In considering consumer sentiment and the key influencing factors in how a mortgage broker recommends a lender, it is clear that the current remuneration structure does not negatively impact the borrower.

Figure 6: Ranking of factors influencing a broker's decision to recommend a lender

	2018	2017	2016*
Product policy	1	1	1
Product pricing	2	2	1
Turnaround times	3	3	3
Credit assessment staff	4	4	6
Valuation ordering online	5	5	4
BDMs	6	6	5
Commitment to channel	7	8	8
Channel conflict	8	7	11
Product range	9	9	7
Client support	10	10	10
Broker communication	11	12	12
Online application status tracking	12	11	9
Online lodgements	13	14	13
Broker interaction	14	13	14
Online resources	15	16	16
Call centre support	16	15	15
Web presence	17	21	19
Business support	18	19	20
Training and education	19	20	21
Commission remuneration	**20**	**17**	**17**
Commission structure	**21**	**18**	**18**
Mobile device interface	22	22	22
Product cross-sell	23	23	23

most important

least important

Data: Third Party Lending Report - Major Banks and Non-Major Banks
*Results from 2016 include non-major banks research only

Section three:
A ‘consumer-pays’ fee-for-service model

Section three explores the alternative; the economics and implications of a fee-for-service model in mortgage broking.

3.1 Understanding a fee-for-service model

As part of the discussion around ensuring the best outcomes for consumers, there have been suggestions that a fee-for-service model could be an alternative to the current commission-based structure. The fee-for-service model would replace the lender commission with a fee paid by the borrower.

To better understand the impact of introducing a fee-for-service model, consumer sentiment towards paying a fee must be considered. As part of this process, it is important to understand whether consumers are willing to pay a fee and if so, how would this fee compare to the current commission paid by the lender.

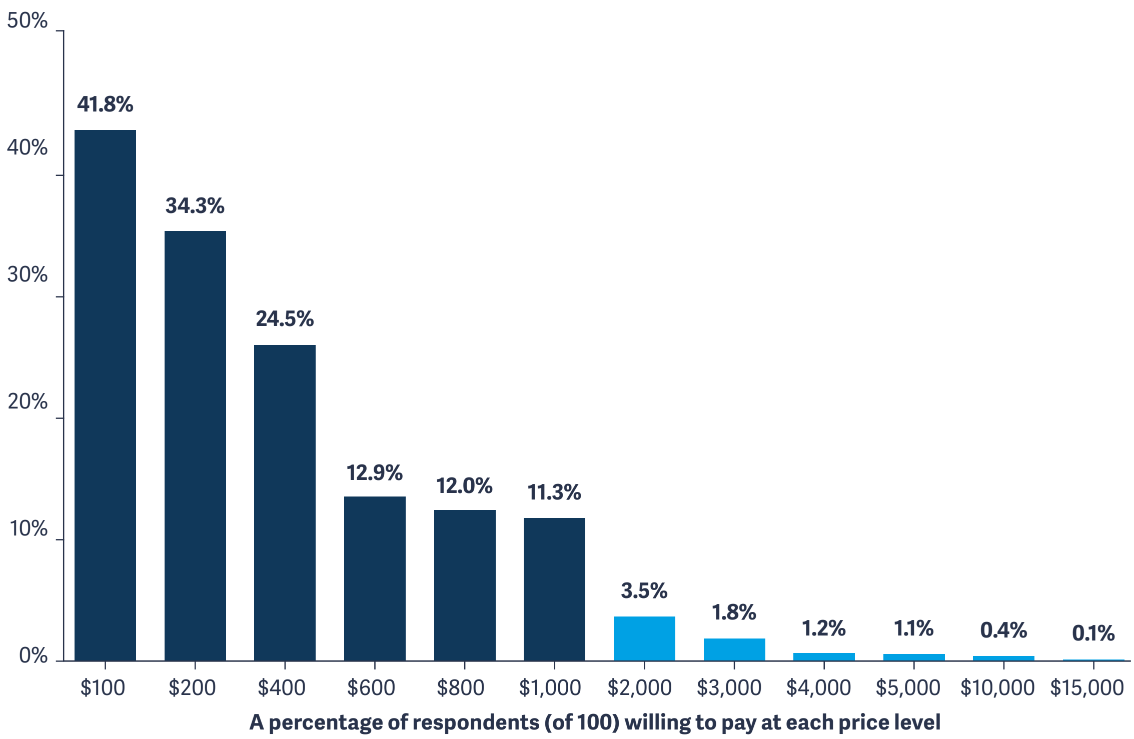
3.2 Consumer attitudes towards paying a fee-for-service

The significant growth of mortgage broking across Australia since inception can be intrinsically linked to the fact that the services of a mortgage broker are typically free of charge.

Results from the Borrower Experience Survey reveal that the majority of consumers (58%) who have used or intend to use a mortgage broker in the future are not willing to pay a fee. While just 3.5% would be willing to pay $2,000 which is comparable to the upfront commission paid on the average sized loan.

Considering that mortgage broker customers have high satisfaction levels and 96% of them would plan to secure their next loan via a mortgage broker, it is critical to recognise that making a borrower pay for a service that up until now has come at no cost may have a dramatic impact on the demand for mortgage brokers.

Figure 7: Percentage of consumers willing to pay a fee-for-service



3.3 Analysing consumer appetite to pay a fee-for-service

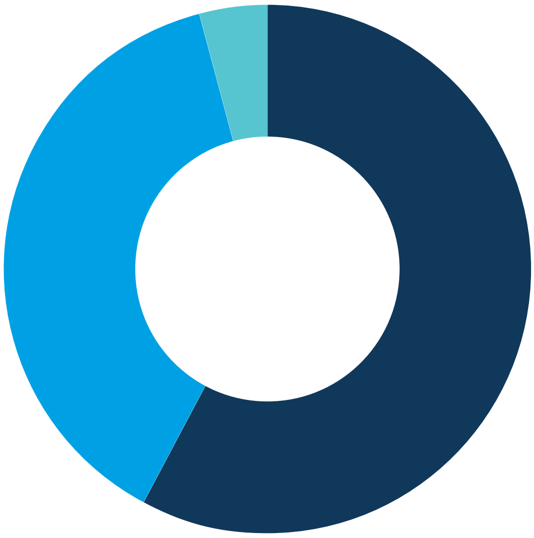
While 38% of consumers would be willing to pay a fee, it is important to consider how much they would be willing to pay and how this would compare to the amount of commission currently paid to the mortgage broker by the lender.

If the average upfront commission of $2,003 were to be converted to a fee paid by the consumer, only 3.5% of consumers surveyed would pay an amount at or above this threshold.

This means that 96.5% of existing mortgage broker customers may be unable to access the services of a mortgage broker to secure finance. This has serious ramifications for the sustainability of the mortgage broker channel.

Note: The analysis above is a conservative estimate as it solely uses the upfront component of the commission structure and does not consider trail commission.

Figure 8: Analysis of consumer willingness



3.4 Outcomes for consumers if a fee-for-service is introduced

While it is worth considering the impact of fee-for-service on the mortgage broker industry, it is of critical importance to consider how a major shift to the proprietary channel could impact the overall health of competition in the mortgage market.

Based on this survey and the analysis above, a large majority of existing mortgage broker customers (96.5%) would no longer use the mortgage broker channel. By default that would mean returning to the lenders with the biggest branch networks.

This would significantly reduce the reach of smaller banks and lenders that have been able to compete with the major banks via the mortgage broker channel.

A reduction in competition and subsequent diminishing market share for smaller lenders would empower the biggest institutions to increase their margins and reduce their product range.

There is a danger that a marketplace dominated by the major banks would result in higher interest rates, tighter lending policy and fewer mortgage products for Australian borrowers.

This concentration of market share could potentially negatively affect consumer outcomes via:

- Increased net interest margins
- Reduced choice of lenders, and
- Diminished service quality

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Appendix A – Borrower Experience Survey

The data for Momentum Intelligence's Borrower Experience Survey was conducted during November and December 2018. A quantitative research methodology was adopted, with participants asked to complete a self-administered questionnaire via an online survey portal.

Surveyed respondents were sourced from Momentum Media's digital databases. The survey was also made available to all brokers in Australia via theadviser.com.au to share with their customers. Survey responses were carefully assessed, measured, and validated through statistical data analysis by a market research professional. There were a total of 6,600 responses received.

A data validation process resulted in a total usable sample of 5,782. A sample of this size provides an excellent confidence level for the study. The margin of error for a sample this size is 0.013 at a 95% confidence level, indicating 95% confidence that the survey sample results represent true population values within a range of +/- 1.3%.

About Momentum Intelligence

Momentum Intelligence emerged from Momentum Media, Australia's leading business media and events company. We conduct market research to help business leaders roadmap their strategic goals.

Having access to Momentum Media Group's highly engaged audiences, we are able to provide research on the perceptions, preferences and priorities of a range of professionals including mortgage brokers, real estate agents, accountants, lawyers, financial advisers, small business owners and the Defense industry.

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