Submission on Commerce Commission Personal banking services market study – Draft Report

Link Financial Group

Link Financial Group is a financial services aggregator and holder of a financial advice provider licence. Our group is home to approximately 120 mortgage advisers. We make the following submission to support the development of the **Personal banking services market study** with focus on **Chapter 4 – Competition for home loans**. In particular, we offer comments on the draft findings relating to the role of mortgage advisers in the distribution of home loan products.

Overall, we support the intent of the study and offer our support to the Commerce Commission in order to better understand the role of mortgage advisers. We found that some statements and views about the role and conduct of mortgage advisers in New Zealand do not align with our views, experience, or evidence. We believe that in order to present an accurate view on the role and conduct of mortgage advisers in the final report, the Commerce Commission should seek to engage more readily with the sector, including advisers themselves, industry bodies, aggregators, and the FMA.

We lay out our comments with respect to each point we wish to comment on.

- 4.109 – We agree with the conclusions made; however, we would like to add comments on potential frictions to consumer refinancing in home lending. In our experience, consumers value more than interest rate prices alone in an environment where main bank offer generally similar interest rates (especially taking discretionary price-matching into account). Refinancing involves a new lending application by the customer. This means that a client is required to invest potentially significant time into a new application. A prudent borrower may seek legal advice when taking up a new loan, incurring a cost to the refinancing. A prudent borrower (as well as a mortgage adviser) may also understand that, at a given point in time a new lender may offer a competitive 1-year interest rate, however as the report shows, in the long run there is no clear market leader on interest rate pricing. Therefore, a consumer looking to continually seek the lowest market rate must invest the time and energy required to continually refinance. A savvy borrower may also understand that discretionary price matching can be offered to them by an existing lender in order to match the offer by another lender to refinance, therefore reducing the need to go through the cost of refinancing but achieving the same outcome.

  Commission incentives favour refinancing for borrowers with a financial adviser. However, advisers are ultimately required to act in the interests of their client and will assist their clients in making the best choice for them.

  4.111 - We agree that lengthy clawback periods make these considerations (regardless of whether the ultimate outcome would be to switch) redundant within the clawback period because of the prohibitive one-off cost to the consumer. We therefore support the reports recommendations that clawback periods be reduced to at least 24 months.

  Advisers have borne the brunt of negative press over clawback charges in recent years. We acknowledge that some instances have occurred and gained media attention where a mortgage adviser could have failed to appropriately communicate the clawback charges. We

have observed that efforts from aggregator groups and advisers, and the new regulatory environment, have improved customer awareness of these fees allowing them to make more informed decisions.

Where customers have refinanced directly with a lender, that lender may not have informed the customer that, because they had obtained lending through an adviser within 27 months, then they should inquire about any potential fees payable. We note that advisers provide a valuable service to consumers, and this is reflected in the feedback that we see about our advisers. Advisers must be remunerated for their work, especially acknowledging much of the work advisers do is unpaid.

- 4.114 – 4.115 - The statement 'as a result, many customers are leaving money on the table in home loan negotiations' doesn't appear to reconcile with previously stated research that, of those customers that switched home loan providers, 43% were motivated by interest rates, fees/rewards or other incentives and that 61% who haven't switched reported no reason to do so. While frictions and inertia could be a reason, we believe stronger inquiry into non-monetary consumer preferences from their home loan provider should be made to better inform the recommendations of the report. We also acknowledge that this research exists in an environment without a clear market leader on interest rate pricing.

- A refinance application is essentially new lending and involves as much time for the consumer. A smoothing of the process could mean that interest rates play a higher role in consumer preferences as opposed to service and time.

- 4.134 – An explanation we offer is that advisers often focus on a particular client base. Therefore, one major bank may be viewed favourably or unfavourably depending on whether an adviser's customer base is culturally based, urban versus rural, first home buyer versus property investor etc. As stated, we believe this supports the idea that service and credit policy should be more deeply explored by the report as a factor in home loan competition.

- 4.136 - We strongly disagree with this hypothesis. Advisers compete on service and expertise. Customers expect specialist knowledge and efficiencies in securing lending. Mortgage advisers are passionate about their job and a basic function is to be well informed on the lenders they recommend to their clients. Mortgage aggregator groups distribute information from lenders frequently and in one location such as a CRM platform to streamline information flows from the various lenders. Mortgage advisers have very strong incentives to have an expert understanding of lender offers and have access to information directly from lenders.

- 4.147 – The draft report is correct to identify that commission payments are a real or potential conflict of interest for mortgage adviser. However, indications that commission payments influence the services provided by mortgage providers are made without evidence, and without regard to the significant commercial and regulatory oversight over how mortgage advisers manage commissions as a conflict of interest. Mortgage advisers are required to disclose to clients all conflicts of interest, commissions, and other incentives (whether monetary or non-monetary, and whether direct or indirect). This includes disclosure of the amount of commission that a mortgage adviser will receive if a customer acts upon the advice given to them, the terms of payment, and the steps that the mortgage adviser has taken to manage that conflict of interest.

Mortgage advisers have a duty under Section 431K of the Financial Markets Conduct Act to give priority to a client's interest. Further, advisers are bound by the Code of Professional Conduct for Financial Advice Services. Code Standard 1 states that a financial adviser must treat clients fairly, while Code Standard 3 states that a financial adviser must give advice that is suitable.

Aggregator groups are required to have oversight over mortgage advisers that are a part of that group. This includes a compliance assurance program inclusive of regular reviews of mortgage adviser files to ensure compliance with all relevant duties. Mortgage aggregators are generally required by major lenders to have an annual external audit of their compliance program, and a sample of mortgage adviser files to ensure compliance with all relevant duties. From our perspective, an aggregator spends a significant amount of resource to ensure that all mortgage advisers within that group are compliant with their regulatory obligations, including the management of conflicts of interest. If a mortgage adviser were found to be favouring their own commission payments over the interests of their clients, they would face severe commercial and regulatory consequences.

Mortgage advisers are required to produce and provide clients with a record of advice that outlines their recommendations and the reason for their recommendations. This holds them accountable to their clients and oversight body for the advice that they provide, and the rationale for that advice.

- 4.149 – An alternative view is that banks have reduced costs associated with their own direct to consumer distribution, and other consumer services (such as branch closures) in favour of third-party distribution. This approach from lenders is clearly evidenced by the increase in lending through adviser channels in recent years. We do not agree that a statement should be made that adviser commissions will ultimately increase interest rates, absent evidence to support this.

- 4.150 – We find the two statements made here confusing. The two stated consequences of this section appear to indicate that the commission an adviser receives will directly impact the cost that a client pays. These two statements also appear to assume that the benefits of a mortgage adviser are only monetary, when our experience is that this is not the case. Should a client be able to express the value of the services they receive from a mortgage adviser in monetary terms, it would not be relevant for a client to compare this to the commission received by the adviser as the client does not pay this (i.e interest rates for clients are not different, and in fact are more likely to be preferential due to pro-competitive incentives, for clients who use an adviser).

  We acknowledge that in limited cases clients may be charged a fee is the adviser commission is clawed back, however mortgage advisers are required to disclose this fee and the situation in which the client would have to pay the fee before the loan is taken up. It would be noncompliant with advice regulations for an adviser to recommend a loan with the knowledge that the client intends to pay this loan back within the clawback period unless the adviser discusses this with client ahead of time and allowed the client to make an informed decision.

- 4.153 – The FMA has been clear that advisers receiving trail commissions are expected to provide at least annual (or as otherwise agreed) service to their clients. Our aggregator group requires regular service be provided to all clients by mortgage advisers, regardless of whether the clients lender pays trail commission. This is common and standard industry practice. We define regular service as at least annually, unless otherwise agreed with the client.

- 4.159 – We agree with the recommendation and believe that this would allow mortgage advisers to increase the value that they offer clients.

- 4.169 – Acknowledging no formal guidance or case law exists on the matter, the FMA was proactive in engaging with the financial advice community through the implementation of the new financial advice regime. Mortgage aggregators, lenders, and third-party compliance providers have invested a lot of resource into articulating clear standards for advisers with respect to the duties they must comply with. We believe that advisers in our aggregator group have a clear idea of what is expected of them to comply with the duties to give advice that is suitable and to give priority to their clients' interests. The standards we have set have been reviewed by third party compliance providers and lenders. However, we are entirely in support of guidance on these matters being issued by the FMA.