Submission to the consultation on ASIC's review of mortgage broker remuneration

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My submission is going to primarily focus on only one aspect of your review. That aspect will be Interest Only (iO) Loans.

Back in the 60's and 70's there really was only one style of loan and it was Principal and Interest (P&i). Back then the majority of bank's clients bought one property and their entire life goal was to pay it down to $0. Also back then there was a pension on offer, once you retired from the workforce. However, ever since Paul Keating introduced superannuation the drive of government has been for the populous to provide for their own retirement so the public purse responsibilities could lightened. With governments being lax at ensuring superannuation contributions have kept pace with societies needs it is now very apparent that superannuation alone will not be the panacea that was hoped. This being the case there is a need for individuals to investigate and implement other methods of creating wealth for their retirement. One of the most effective ways of doing this is through investment, whether it be property or shares. In order to invest one needs to borrow and in order to invest appropriately one needs to take advantage of taxation law. How do you do this with a loan well, you approach a broker and have them work in synch with your accountant to obtain a suitable facility to both assist you to optimise the ability to repay owner occupied debt as well as to avail investment debt. In the process you, the client gains Financial Literacy - the thing that is not taught in schools.

Thankfully, in the last 10 or so years there is a new style of loan available as well. It is often called a Master Limit. This style of loan is far more flexible than the traditional 'old' P&i facility as it offers a whole range of operational characteristics:

- it can have a large portion which may very well reflect the owner occupied debt on the security property. This section can be interest only (iO) or principal and interest (P&i). This section can also have an offset account linked to it. In the case where a client has a large income and hence the ability to save substantial amounts of money they are better off having an iO facility and placing all their savings into the offset as this has the effect of paying down or reducing the debt far quicker than by the traditional P&i processes. Conversely, where a client has a lower income they may receive a greater benefit from a P&i loan but still with an offset attached so any extra cash they have can be effectively saved into this portion and hence reduce their owner occupied or non-tax deductible debt.
- sitting above this core debt portion there can be any number of splits which ideally are set up for investment purchases. I like to look at these portions as 'seed' capital - each portion representing something in the order of 20% (+ stamp duty) of what is needed to purchase an investment property. I have set clients up with such a facility on numerous occasions. Upon doing so I provide very strict instructions that this 'available' debt is only for investment and as such, <u>not to be touched</u> for anything else. Some clients take many years before they are ready to invest but as this debt is not used there is no ongoing cost to them. Handled appropriately a client may well have the ability to purchase a number of investment properties when they have achieved the financial literacy and comfort level to do so.

When this loan is structured correctly the client is very well placed to assist themselves to cater for their own retirement, over and above what superannuation will provide for them. This is wise, this is appropriate and this involves working with professionals to improve their financial literacy and prepare appropriately for their future.

This is something that mortgage brokers are very good at. When professional, they work with the client and accountant with the aim to assist the client to obtain financial knowledge and independence earlier in their life than they quite often would otherwise.

With the recent focus on interest only loans by both the ASIC and APRA the client is now materially affected and their ability to provide for their future is compromised. The banks have become APRA's pit bulls and are actively discouraging iO loans to the point they are even targeting existing clients. This is abhorrent! Clients have in good faith taken out a loan product, after evaluating it for their purpose. They have assumed, as has been the case for at least a decade, that the rate for an iO loan would remain the same as that for a P&i loan only to find that through a push from ARPA they are having the rug pulled from underneath their feet. Sure the property market has been overheated but that is not each individual client's fault that is the fault of the politicians who have not monitored the situation and adjusted legislation where needed.

Should this iO push continue with the same aggression as present there is the very real prospect there will infact be a massive correction in the property market as humble clients who have strategically set out to improve their future are forced to sell the assets they have acquired. Honestly, has this strategy of iO focus really been thought through?
O'kay so that is the investor and why they may have an iO loan - in summary to maximise tax deductions and use tax law to assist in creating wealth.

Who else may benefit from an iO loan?

1. First Home buyer - really a first home buyer, is that wise I hear you ask? Whilst on the surface it may not appear so, when one digs deeper it can indeed prove appropriate. The reason behind this may well be due to a low initial income, when they first enter the workforce and the very simple need to just <u>get onto the property ladder,</u> as every month they are not there they become further and further behind the eight ball. With monitoring and appropriate management a broker can enable a novice and naive client to secure a property and in due course revert their loan to P&i. Another factor that makes it hard for a FHOG client is that with the lowering of the HECS trigger they are placed in a position of having to pay their HECS debt back sooner. This directly impacts their ability to purchase their first home. iO repayments can alleviate this extra pressure and enable a FHOG to secure a dearly sought asset.

2. A first home buyer who simply cannot purchase a property in the overheated capital city markets. There are some first home clients who have no real hope of purchasing a property where they would truly love to live. Instead, their only option is to purchase an investment property in a more regional location with the hope that it will experience capital growth and through that, and an increase in their own salary, they may be able to get a leg-up so as to buy where they desire at a later date. This can be a very effective strategy provided the homework is done as to where to buy. The thing is, when the property they are to buy will be an investment property they need to be able to make iO only repayments so as to maximise the tax benefits. A P&i loan simply does not do this. Why then, when this strategy is employed so they can ultimately purchase

their own home, should they be penalised and have to pay a higher interest rate because their loan is interest only. Is this fair? Will this extra cost not only further delay their ability to ultimately liquidate their investment and buy their first real home?

3. A pensioner. Are you serious? Yes, I am! I have a client who is on the disability support pension. As such she is the lowest of the low when it comes to a bank's client base. The outcome of this is she is offered the least attractive product available with; high interest rates (due to the small loan size), monthly fees and P&i <u>only</u> repayments. Life for her was tough. She was only just managing to scrape out an existence. She was seriously considering selling her house which would mean she would have to rent which would be no easier and far less certain. Another complexity she simply did not need. In this particular case she was not only my client, she was my sister. I found the situation disgusting, so I challenged the bank - I asked them to offer her a better rate, do away with the monthly fees and convert her loan to iO. Initially they were unreceptive but when I went on to inform them I was endeavouring to save an asset so that ultimately it may be passed down to her children and that in the process she would have an easier life they came around. Now, I am sure this would not sit with both your views or indeed that of APRA but this is a very real situation where an iO loan is indeed beneficial. In fact, exceptionally so as otherwise there was a very real prospect, if she had sold her home, she would have ended up homeless.

I know in your review you have compared loans from a broker with loans directly from a bank. From where I sit the loan through the broker is far more appropriate for the client than a loan from a bank. The primary reason for this is; the broker endeavours to educate the client where the bank employee does not, either through lack of desire or quite often through a lack of knowledge themselves. When educating the client the broker takes into account a much more holistic approach, looking at whole of life lending rather than simply that of a once off home loan. When considering whole of life lending one must evaluate current taxation parameters available to the client and liaise with the client's accountant in order to ensure they are correctly addressing the client's needs. A broker seeks to develop a long term relationship with a client in order to assist them along a financial journey.

In closing here are my views on a couple of other points from your review:

- I have never liked soft dollar incentives. They should simply be done away with.
- Loyalty programs - high performance or priority approval paths - should also be done away with as they only encourage a broker to lodge more deals with that institution, in order to keep that path open, which may not be in the best interests of their client. Rather <u>all</u> lenders should offer the same level of service to <u>all</u> brokers if we are to be at all impartial in our provision of advice to our clients.