

21 May 2009

Dear Sir or Madam,

RE: National Consumer Protection Bill 2009

My name is Geoff Brieger and I am currently the managing director of Innovation Set Pty Ltd, a software provider to the mortgage industry.

Further, I: -

- was the founder, owner and director of a mortgage management and origination business (Greater Freedom Pty Ltd from 1997 to 2005);
- am a former vice-president (2006) and State councillor (2004 to 2006) of the Mortgage and Finance Association of Australia ("MFAA") in Queensland;
- am currently a regular member of the MFAA Disciplinary Tribunal in Queensland;
- hold a Diploma of Mortgage Lending from the Securities Institute (March 2000).

Next week, I take up the position of managing director of Vanilla Loans, a new mortgage broking business that will refuse to accept commissions from lenders and operate on a fee for service basis to borrowers (i.e. a true mortgage broker as opposed to a lender's agent).

I congratulate you on the draft "National Consumer Protection Bill 2009" and am writing to contribute to improving it by highlighting concerns and raising matters for your consideration.

Point 1 - Declaration of Interest

The legislation does not appear to require a credit service provider to declare its interest to the borrower in terms of duty of care. In other words, is the credit service provider acting for the lender, the client, both lender and client, or just itself?

Please consider the inclusion of such a declaration.

Point 2 - Unsuitable Loans

The idea of identifying when a loan is considered to be not suitable for a consumer is of particular concern.

Please refer to clause 2.7 (page 20) of the Exposure Draft Bill 2 (attached) in which your example appears to be very straightforward. However, a deeper understanding of interest savings demonstrates otherwise.

There are 5 main factors in a loan that drive interest savings, being interest rate, fees and charges, frequency of payment, amount of payment per frequency and transaction flexibility. The latter three points combine to determine the level of extra payment savings and offset savings that may be generated (explained below in this letter).

I believe that mortgage brokers should be required to explain and consider all 5 factors in relation to each borrower. This would not be a popular development for mortgage brokers, because most would prefer to focus their sales process entirely on interest rates and fees.

To explain, a \$175,000 loan at 5.5% will cost you \$993.63 per month for the next 30 years and you'll pay \$182,707.49 in interest - \$357,707.49 in total.

If you take the same loan and pay \$496.82 per fortnight (i.e. half the monthly payment), it's paid off in 24 years and 10 months. Interest is \$146,064.87, so you're \$36,642.62 better off.

The result comes about because 26 payments at \$496.82 (\$12,917.32) is more than 12 payments at \$1,419.47 (\$11,959.56); and because interest is calculated on a loan balance that is reducing fortnightly instead of monthly.

Note that in the above example, the interest rate of 5.5% has not changed; highlighting the fact that savings are made by increasing the repayment amount and the frequency of repayment.

It is therefore confounding that the question most overlooked is how a borrower can make the maximum repayment at the optimal frequency.

The surprisingly simple and indisputable fact is that the maximum repayment and optimal repayment frequency is achieved by paying all your income into the loan on the day it is received. That being the case, to employ such a strategy requires a borrower to obtain a loan facility that offers full transaction flexibility.

Unlike a loan with a redraw facility, which often has a minimum redraw amount and/or prohibitive fees to redraw (e.g. \$2,000 minimum redraw @ \$50 for the privilege), a transactional loan (as defined by the MFAA) allows you to transact freely from the loan itself by ATM, Internet and cheque; or from an offset account operating in conjunction with the loan.

To benefit from this flexibility, all salary is deposited directly into the transactional loan or offset account as received, where it saves 5.5% (i.e. the example home loan rate) until withdrawn as cash from the ATM, or used to pay bills.

Surplus cash automatically becomes extra repayments on the home loan and savings are increased by leaving money parked in the loan until it needs to be used; which is like having a flexible investment with a guaranteed, after-tax return of 5.5% - without any risk.

This in turn, artificially increases the average monthly repayment to an amount which is greater than income less expenses - a repayment amount that is otherwise mathematically impossible to achieve.

So by doing this (i.e. the interest minimisation strategy as defined by the MFAA), the same 5.5% home loan can now be paid off in 9.25 years and the borrower can save an additional \$97,731.44*.

Clearly then, the very best home loan has the lowest interest rate, no fees and charges, and offers full transaction flexibility to enable the borrower to make the maximum repayment at the optimal frequency (i.e. to generate extra payment savings and offset savings).

And coming back now to clause 2.7 of the Exposure Draft Bill 2, what if a transactional loan could only be obtained at a rate which is 0.5% higher than the rate of a suitable non-transactional loan? Subject to the income and expenses of the borrower, it may well be possible that greater interest savings can be achieved with the transactional loan which is 0.5% higher than the non-transactional loan.

In summary, the question of a loan being "not suitable" is far more complex than it may appear and can only be resolved by requiring mortgage brokers to explain the facts relating to interest savings and then by enabling a borrower to choose between an interest minimisation strategy using a transactional loan, or a traditional strategy using a non-transactional loan (with repayments and repayment frequencies agreed at levels which can be reasonably attained).

I propose that: -

- Mortgage brokers should be required to explain the effect of increased repayments and payment frequencies, and to assess the level of repayment that a borrower might reasonably make; and
- Credit service providers should be held accountable for losses by consumers under the Bill if they fail to demonstrate to borrowers how to achieve maximum interest savings and do not provide borrowers with the option to pursue such interest savings.

The prescribed process may be: -

- Explanation of the 5 main factors in a loan that drive interest savings
- Selection of transactional loan or non-transactional loan
- Selection of loan type (e.g. for a transactional loan it would be line of credit, principal and interest redraw, or term loan with offset)
- Selection of loan product based on best interest rate, fees and charges - and factoring other parameters which may relate to the specific circumstances of the borrower (e.g. loan to value ratio or security acceptability to a lender).

Without such a process, consumers will continue to be robbed of facts that could save them many thousands of dollars, and the good intent of the legislation may suffer an unexpected defeat in a farcical Court action.

I have stated the inconvenient truth and now challenge the Government to impose proper requirements upon credit service providers.

*Based on an annual net income of \$59,800, annual expenses of \$35,880, and loans as described herein.

Point 3 - Interest Minimisation

Also referred to as mortgage reduction or elimination, interest minimisation is the primary focus of approximately 15% of mortgage brokers and has been previously viewed as problematic by consumer groups and ASIC.

The only proper practice document on the subject of transactional loans and interest minimisation is a set of guidelines that now form part of the MFAA's Code of Practice (guidelines attached).

I am proud to have been the initiator of these guidelines for which Innovation Set Pty Ltd bestowed its proprietary definitions and significant experience.

Having worked as the principle advisor to Phil Naylor (CEO of the MFAA) during consultation with ASIC and industry members to formulate these first-rate guidelines (which were signed into the MFAA Code of Practice in February 2009), it is disappointing that the MFAA has subsequently failed to promote them adequately.

A single article about the guidelines was published in the August 2008 edition of Mortgage & Finance Brief (article attached) and the MFAA has chosen not to offer any training sessions or online modules to its members on this subject.

As a result of the apparent apathy by the MFAA, its members remain largely unaware of their obligations and in my opinion, most continue to engage in questionable behaviour (born of ignorance) when promoting interest minimisation.

The entire matter of interest minimisation appears to have been overlooked in the draft Bill and I call upon the Government to take this opportunity to install procedures relating to interest minimisation; by studying the guidelines and amending them for inclusion in the Bill.

In considering improvements to the guidelines, I suggest removal of the words "and whereby the member quantifies potential savings" from the final paragraph of Part "A".

This change is recommended because the vast majority of mortgage brokers will describe the interest minimisation strategy from time to time without necessarily quantifying potential savings. When they do so, borrowers should be given an option to take up a post-sale management program to obtain proper education and disclosure as described in the guidelines.

In my new role as managing director of Vanilla Loans and in the absence of any requirement or guidance under the Bill, I intend to deem all transactional loans not suitable when the interest minimisation strategy is explained by my credit representatives, unless the borrower is provided with a post-sale management program in the manner prescribed by the existing MFAA guidelines.

4. Educational Requirements

It is widely tipped that the Certificate IV in Financial Services (Finance/Mortgage Broking) will be the standard educational requirement by a credit service provider to obtain an Australian Credit Licence.

I do not object to this, but would recommend that higher educational qualifications also be accepted and listed. The MFAA currently supports a situation for its AMC qualification, whereby a broker might have a university degree in finance, but still needs Certificate IV to gain AMC status.

It took me a year to obtain a Diploma of Mortgage Lending (24 workshops, assignments and examinations) from the Securities Institute (Now Finsia), so I find the MFAA requirement absurd and ask you to include the Diploma and other higher qualifications.

If the Minister or his representative would like to discuss any of the points made in this letter, I would be delighted to meet at the MFAA National Conference on the Gold Coast in June (Senator Sherry is attending on Friday, 5 June) or any other suitable time.

Yours faithfully,



Geoff Brieger
0412 869849
gb@etracka.com