Do Mortgage Brokers Have Clients' Best Interests at Heart?

How do New Zealand mortgage brokers select a lending bank?

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ABSTRACT

In the New Zealand market banks pay mortgage brokers for the introduction of residential mortgage lending business The remuneration structures offered by the different banks are not the same, however, and this paper looks to explore brokers' responses these different rates of remuneration. The principal finding of the research is that brokers are more strongly influenced by the quality of service than by the payments received from the lenders.

INTRODUCTION

Over the last ten years the mortgage broker industry in New Zealand has grown from being insignificant to a legitimate home loan procurement source for many lenders. ASB was the first major New Zealand bank to embrace mortgage brokers, using them to expand beyond its traditional Auckland and Northland operational areas. Other lenders quickly acknowledged that the mortgage broking industry was either a threat to their businesses or an opportunity to be exploited. As more lenders recognised the mortgage broking industry as "legitimate", mortgage brokers found that they had more lender options to offer to their clients, and hence became more "marketable".

Mortgage brokers are being used by an increasing number of borrowers. Previous research has shown that mortgage brokers consider several factors when selecting a lender for a client, such as fast loan approval times, loan pricing, and client service (Salomon Smith Barney, 2000; Macquarie, 2000; Drylie, 1999). However, there has been no conclusive research examining how individual mortgage brokers weight the various decision factors to arrive at their recommendations.

The objective of this study was to assist in providing New Zealand lenders, home loan consumers and mortgage brokers with useful information on how New Zealand mortgage brokers select a lender for their clients. Specifically, the study sought to:

- Ascertain the most significant factors mortgage brokers consider when choosing a bank
- Determine the relationship between the decision-making factors
- Ascertain whether mortgage brokers view their needs ahead of clients' needs
- Begin discussion about whether new disclosure rules and regulations need to be introduced to protect mortgage brokers' clients

The study used traditional survey methods, together with a review of relevant literature and anecdotal evidence to provide a better understanding of mortgage broker decision-making.

EXISTING LITERATURE

The development of the mortgage broker industry

A mortgage broker is "an independent real estate financing professional who…by combining professional expertise with direct access to (many) loan products…provides consumers the most efficient and cost effective method of offering suitable financing options tailored to the consumer's specific financial goals" (Council on Financial Competition, 2000). A mortgage broker, therefore, is an independent party who, for a fee[1], assists a borrower to raise a loan.

Mortgage broking in New Zealand has experienced significant growth over the last 10 years. Prior to the early 1990s, mortgage brokers generally concentrated on finding lenders to assist borrowers with commercial loan propositions that might otherwise be regarded as unattractive, or to arrange loans under terms and conditions that were more attractive. In 1991, it was estimated that residential mortgage business procured through mortgage brokers made up approximately one percent of loans in New Zealand, increasing to more than seven percent by 1996 (Staff, 1997 November).

This growth has continued and by 2001 mortgage brokers were thought to provide approximately 25-27% of all new residential home loans written by banks (Jury, 2000; Consumer Banking Monitor, 2001). Previous studies (Hayward, 1999; Jury, 2000) found that, on average, clients of mortgage brokers were on income levels above the New Zealand average and a greater percentage were tertiary educated than the overall New Zealand population. This suggests that mortgage brokers are now dealing with wealthier and more knowledgeable clients than was previously the case[2]. Lush (1996), Drylie (1999), Macquarie Research (2000) and Jury (2000) have suggested that banks that do not use this source effectively may find they miss out on a significant segment of the mortgage market.

Overseas experiences confirm a similar rapid growth in the mortgage broking industry. Jury, 2000; Council on Financial Competition, 2000; Drylie, 1999 cite the level of broker referral business in both Australia and the United States as proof that New Zealand's industry will experience further growth. Estimates range from 50 to 90% in the United States (Lush, 1996; Council on Financial Competition, 1998; Council on Financial Competition, 2000; Jury, 2000)

[1] In New Zealand, this fee is normally paid by the lender.
[2] Mortgage brokers in New Zealand were previously only used by clients who had trouble raising finance (Drylie, 1999).

and 20 to 40% in Australia (Steeman, 1997; Council on Financial Competition, 1998; Kumar, 2000; Macquarie Research, 2000; McLachlan, 2000). These variations arise as brokers and banks in these countries are under no obligation to provide information on business procured through brokers, the definition of mortgage broker originated loans can vary considerably[3], and the broker industry may "talk up" its percentage contribution.

The growth in mortgage broking in New Zealand and internationally can be attributed to a variety of factors, although the more deregulated and competitive finance industry is a key factor. Other factors behind the growth include:

1) The increasing number and range of loan products
2) Increased urgency and complexity of individuals' financial management
3) The rapid growth in personal investment advice as a stand-alone business
4) On-line access to advice that reduces cost and increases customisation

(Council on Financial Competition, 1998).

KPMG's 1999 Financial Institutions Survey also suggested "increasing customer dissatisfaction with the standard of service provided by banks is allowing mortgage brokers to flourish". Salomon Smith Barney (2001) suggests that the growth in the mortgage broking industry in Australia (a similar market to New Zealand) has been brought about through:

1) Bank branch rationalisation and staff reduction, leading to banks replacing their "fixed-cost branch networks with a sales-focused variable-cost work force"[4].
2) Anti-bank sentiment leading to consumers feeling more comfortable with an "independent" third party.
3) Lenders taking the mortgage broker industry seriously (due to the amount of business written through this channel).

The main reasons clients approach mortgage brokers, in order of importance, are: a belief the mortgage broker will find them the best "overall" deal; the convenience of meeting with a broker; the belief the broker will find the best interest rate; the speed of the loan approval; the expertise of the broker; and clients' dissatisfaction with their existing bank's service (Jury, 2000). These reasons align with the main reasons brokers think that clients use them (Drylie, 1999).

[3] In Australia, for instance, originators that act only for one financier can be included as broker, but they would not be classed as a broker under the NZMBA's definition

[4] Matthews (2000a) reported that New Zealand had the second to lowest ratio of branches to population of nine countries studied.

Types of brokers

Writing about the Australian market Salomon Smith Barney (2001) identified three broker business models, which can be readily translated into the New Zealand environment.

The one-man show. These are the traditional mortgage brokers who are former bank managers or salesman. Business writing levels are capped due to physical resources, number of contacts, and cost of technology and marketing. These businesses are also faced with lower commission levels from lenders who reward based on volume.

Franchise model. Mortgage broker franchises, such as Mike Pero Mortgages and Mortgage Choice, sell franchises to screened accredited brokers who use the franchise's brand, network, systems and technology to promote their services. Most businesses have an entry fee (up to $50,000) and a percentage of commissions are paid to the franchisor. Due to the volumes of loans these businesses generate, they are well-placed to pressure lenders for higher commission payments.

Aggregator model. With many lenders now paying higher commissions based on the volume of business referred, and the advent of trailer commissions[5], many brokers have formed associations so as to pool loan volumes and thus increase commission received. The aggregator business model allows brokers to continue to operate their businesses separately without the need to pay expensive franchise fees and share commissions with the franchisors.

Mortgage brokers have the option of belonging to the New Zealand Mortgage Brokers Association (NZMBA). The NZMBA was established in late 1997 with the aim of increasing the professionalism and quality of participants in the industry. It is estimated that 60% of people whose principal activity is mortgage broking belong to the NZMBA (Tucker, 2001). Many operators act as part-time mortgage brokers, while carrying out other activities, such as insurance agents, solicitors, and accountants. Many of those that act as mortgage brokers do not

[5] Trailer commission is similar to the insurance industry's commission payment structure, where the broker receives a percentage of the products profit, whilst the organisation holds onto the client. In the case of New Zealand lenders a trailer commission of between 0.15%-0.25% of the remaining loan amount is paid to the broker each year the loan remains on the lenders' portfolio.

belong to the NZMBA, because they either see no real benefit in belonging[6] or do not meet the Association's criteria[7].

Factors that influence brokers' decisions

Supply-chain management is becoming an important business tool for both goods and services industries, to ensure that they are delivering the right product to the right place, at the right price. Effective supply-chain management requires businesses to assess how the various components of their business interact. In the case of mortgage brokers, those lenders that understand what factors motivate brokers to refer business, and how these factors interrelate will be in a stronger position to manage future business levels profitably.

The residential home lending market is highly competitive in New Zealand, with interest margins among the lowest in the world, and a high number of bank and non-bank competitors in a relatively small mortgage market (KPMG 1999). These factors create an industry with similar pricing for its products (Macquarie, 2000)[8]. A question, therefore, exists: With interest rates deemed by brokers as the most important consideration when recommending a particular lender (Drylie, 1999), why do some lenders win broker business over others? Macquarie (2000) and Salomon Smith Barney (2001) suggest that if there are no pricing anomalies, banks offering the best service to the mortgage broker have the potential to attract a larger slice of the business.

Macquarie (2000) indicates that lenders identifying the key needs of the brokers, and successfully building relationships with them, will have an advantage over peers. They suggest that commission levels do not play a large part in Australian brokers' decisions to recommend a particular lender, as commission payment structures are relatively similar. Macquarie believes that fast loan approval, settling on time and prompt payment by the bank of fees to the broker are the main reasons for brokers referring business to a particular lender.[9] Drylie (1999) provides some support for Macquarie's findings.

[6] The mortgage broking industry is currently unregulated. At present lenders do not differentiate between members or non-members of the Mortgage Brokers Association. However, the Association is starting to exert pressure on lenders to favour members of the Association over non-members.

[7] Acceptance into the Association is conditional upon satisfying conditions such as passing entry examination, no criminal convictions, having agreements with six or more lenders, operating within certain ethical guidelines, amongst other requirements.

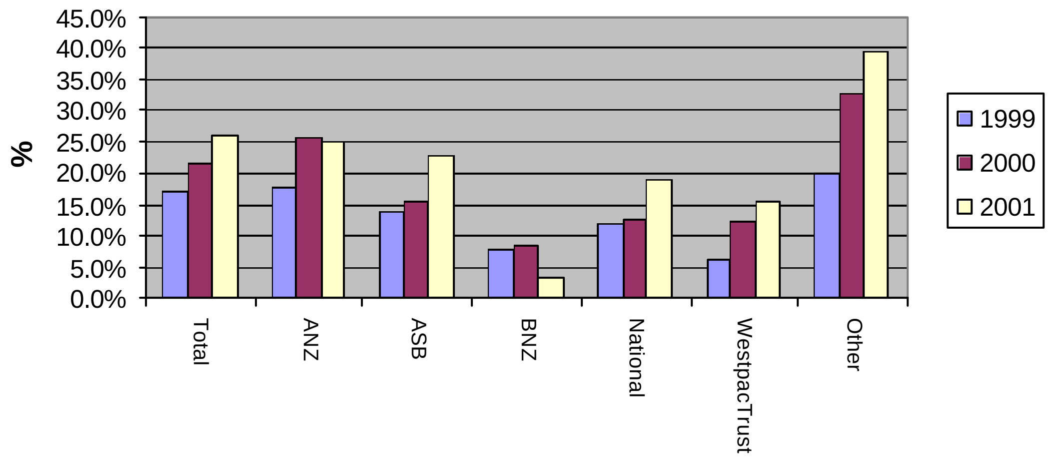
[8] This is highlighted through comparing the home loan interest rates of New Zealand banks. Comparisons on 11/10/00 and 22/10/01 show New Zealand's five largest banks advertising exactly the same prime floating home loan interest rates.

[9] The Macquarie article reports what is essentially anecdotal information, rather than being based on structured research. Reference is made to it because of a dearth of previous structured research.

Whose interests, therefore, do mortgage brokers look to serve? Ultimately it is their own survival that will determine their mode of operation. Already we have seen operators in Australia promoting themselves to consumers with the stated advantage of having the same commission levels with all lenders, reflecting a belief that accepting varying commission levels from lenders affects brokers' impartiality (Kumar, 2000). Moreover, several brokers are creating loan analysers based on what is important to the client, to assist the client to select the lender that suits them best, placing the client in control and removing the broker's bias from the equation (Kumar, 2000).

New Zealand lenders have put considerable resources and efforts into attracting business from the mortgage broking industry. Figure 1 shows the pay off from these efforts, with all New Zealand banks, except BNZ, growing their share of business through this channel[10].

Figure 1: Loans Procured Through Brokers



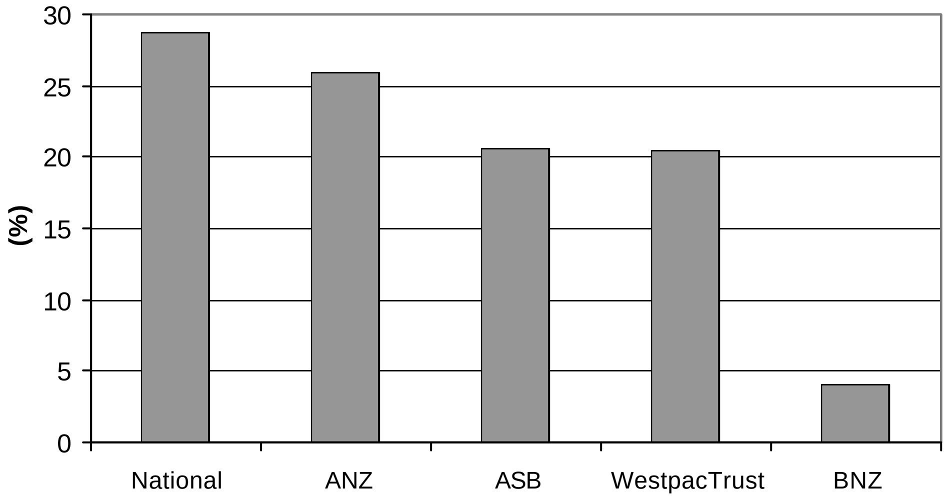
(Source: Consumer Banking Monitor)

The total share of business sourced from brokers has steadily increased. Among the five major banks, the National Bank received the largest increase in broker referred business, increasing 6.8% in two years, although growth for "Other" lenders has been greater, reflecting the value of this cost effective delivery channel for those less-established lenders who often lack branch networks. For the BNZ, business received through broker sources has shrunk to less than 5%;

[10] 2001 is for the first two quarters only. Sample sizes are small. For example the 2001 results are based on response numbers ranging between 35 and 60 for the various New Zealand banks. Moreover, the Consumer Banking Monitor is also prone to distortion because of the way data is collected and is reported. For example, the aggregate data that it generates is often inconsistent with that determined from relative market shares calculated from banks' disclosure statements. Note that the Consumer Banking Monitor breaks performance data down among the 5 major banks – ANZ Banking Group (New Zealand) Limited (ANZ), ASB Bank Limited (ASB), Bank of New Zealand (BNZ), The National Bank of New Zealand (National Bank) and WestpacTrust – and other.

anecdotal feedback suggests a major reason is the bank not allowing brokers to promote its Global Plus Home Loan[11].

Figure 2: Major New Zealand Banks Share of Broker Business



(Source: Consumer Banking Monitor)

Figure 2 shows the estimated share of total broker referrals to the major banks that each bank receives[12]. The National Bank appears to receive a slightly larger share of the mortgage broker business than ANZ and approximately eight percent more business from this channel than ASB and Westpac Trust. The BNZ does not feature as a significant player in broker originated home loans.

[11] The Global Plus Home Loan provides BNZ Global Plus customers with 'Air Points' based on the loan size.
[12] Due to the small sample sizes in the Consumer Banking Monitor caution should be exercised in placingsignificant reliance on this information. Note also that other banks and lenders are not included.

DATA AND METHODOLOGY

The data collection method employed was a mail survey to mortgage broking firms. The survey population comprised all people who considered themselves mortgage brokers. Due to the nature of the industry, identifying the numbers of mortgage brokers in New Zealand was a difficult task, mainly because the industry is unregulated; allowing anybody to choose to call themselves a "mortgage broker". It is estimated, however, that there are approximately 430 firms and 800 individuals who act as mortgage brokers[13].

The survey randomly sampled businesses with advertisements in the Yellow Pages, using the category "Mortgages and Loans" on the Yellow Pages' web site (www.yellowpages.co.nz). The sample of 218 randomly selected firms represents 25% of the estimated total number of mortgage brokers in New Zealand and approximately half the total mortgage broking firms.

The questionnaire consisted of 11 closed-end quantitative questions, and a final question, which provided an opportunity for broker respondents to make open-ended comments on their main influences for referring business to one lender over another.

The questionnaire was designed to obtain the following information:

1) The sample's characteristics (question 1,2,3,4).
2) The influence that brokers have on the client's decision to choose a lender (question 6).
3) Reasons for using mortgage brokers (question 5).
4) Factors that impact on the broker's decision to select a lender (question 7, 10, 12).
5) The broker's decision-making process (question 7, 8, 10, 11, 12)

Surveys were mailed in early July 2001. Ninety-one surveys were returned completed and four returned by recipients that did not wish to participate. The overall response rate was 42.5%. This response rate is considered acceptable and falls between similar studies carried out on the New Zealand mortgage broker industry[14]. The total sample of 91 meets the minimum sample required to provide 95% accuracy for each question (Easterby-Smith et. al. p. 124)[15].

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[13] This is estimation is based on discussions with the NZMBA and a search of the Yellow Pages in the major telephone directories.

[14] 33% (Lush, 1996) to 66% (Drylie, 1999).

[15] Based on n = 2500/25 and as the population is known to be approximately 800: then 100/(1+100/800)= 88 samples required as the minimum to achieve 95% accuracy.

The survey results have limitations. First, a non-response rate of 57.5% confirms a non-response bias, with the characteristics and views of the non-respondents potentially differing from those of the respondents. Second, although the number of returned questionnaires is acceptable, an increased sample size may have provided a higher degree of accuracy, especially with respect to questions nine and ten where invalid responses were higher. Third, the inclusion of a letter from the NZMBA encouraging brokers to complete the survey may have provided a disproportionate response from NZMBA members. However, this does not appear great (66% of sample are members, compared with 60% of estimated population) and is not expected to have a detrimental impact on the findings.

Other limitations include the subject and design of the survey. Some brokers when asked about factors that influence their choice of lender were likely to provide "socially desirable" responses. Brokers may tend to place themselves in the "best light", either intentionally or unintentionally, in order for the industry to be seen by the researcher and intended readers as "trustworthy and sound".

RESULTS

In terms of the characteristics of the sample, the mean number of years as a mortgage broker was 4.8 years, and 79.5% of respondents had been a mortgage broker for no more than 6 years. Most respondents (63.6%) were from firms with fewer than six brokers, while just 20.5% were from firms with 11 or more brokers. Only 6.7% of respondents did not meet the NZMBA requirement of having agreements with 6+ lenders, and 79.8% had eight or more.

Brokers influence

A broker is only the intermediary between the lender and the borrower, with the borrower making the final decision on which lender to deal with. It has been acknowledged (Hayward, 1999; Drylie, 1999; Holoyda, 2000), however, that the broker plays a significant role in selecting the appropriate lender. Respondents were asked to indicate on a 7-point Likert scale (from 1-strongly agree to 7-strongly disagree) how much influence they believed they had over a client's decision to choose a particular lender in five situations.

Table 1: Amount of Influence Brokers Possess

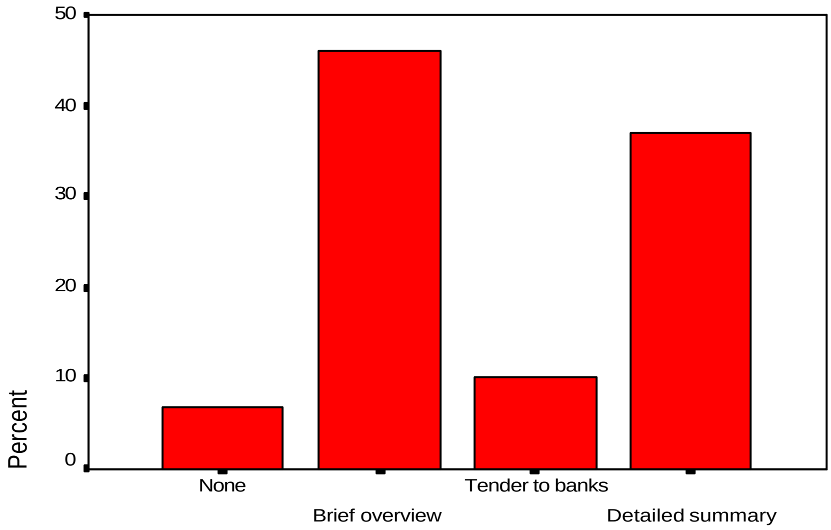
Brokers Influence	No.	Mean	Std Dev.
a) As a general rule	91	2.2	.93
b) When client's knowledge is low	90	1.7	.91
c) When client's knowledge is high	91	3.1	1.2
d) When level of client's wealth is high	91	3.0	1.22
e) When level of client's wealth is low	91	1.7	1.10

Table 1 presents results showing that broker respondents believe they have significantly more influence when client wealth or knowledge is low, than when the client's knowledge or wealth is high. This is understandable as clients with little or no knowledge about the loan process may leave the decision to the broker, who is deemed to be the "expert".

A broker's increased influence over lower quality applicants may be connected to the borrower having fewer lenders to choose from, due to not meeting other lenders' credit criteria. The broker, therefore, plays a greater role in influencing a lower quality applicant than if the client qualifies with a large number of lenders.

Brokers believed they had a similar level of influence with clients with a high knowledge of the loan process, as when the client's wealth is high[16]. This may be due to clients with more wealth (higher equity and income) generally being those who have participated in purchasing properties and borrowing money previously. A relationship also existed between the situations where the client's knowledge and wealth is low[17].

Figure 3: Information Provided by Brokers

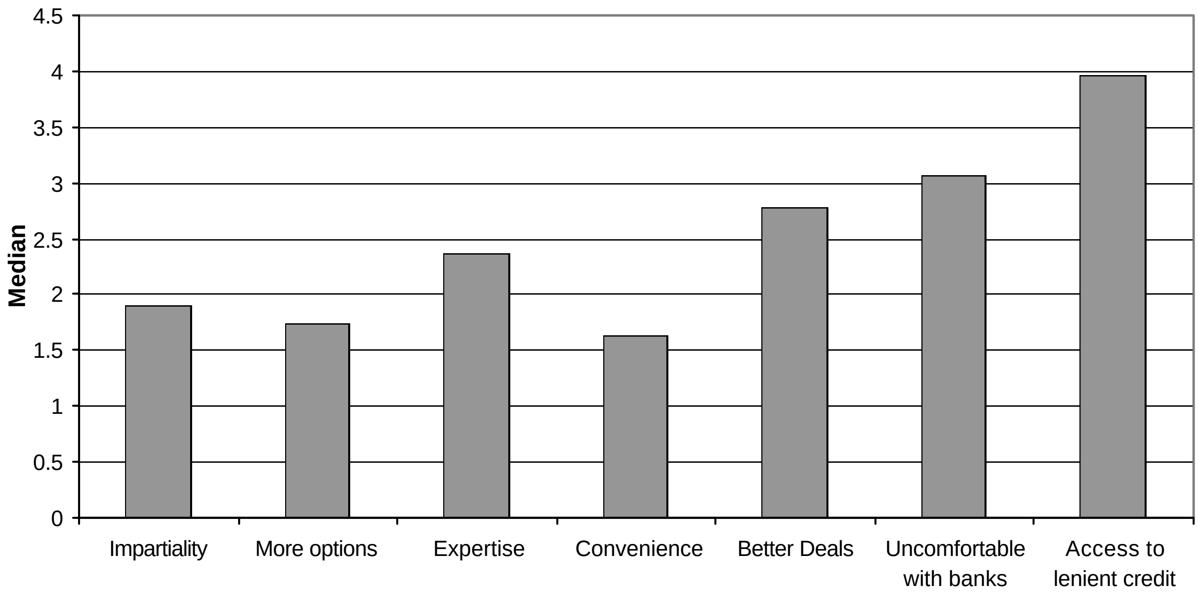


Although brokers believe they can strongly influence the client's choice of lender, Figure 3 shows that 6.3% of respondents do not provide the client with any information at all on the options available. The highest proportion of respondents preferred to provide a brief overview of the interest rates and fees of lenders 'they' think would suit (43.2%). The balance either provide a detailed summary on several lenders, by comparing the factors the client believes important (34.7%), or send the application to more than one lender on a tendering basis (9.5%).

[16] Pearson's correlation coefficient of 0.700 suggests a positive relationship between these factors - p-value .000
[17] Pearson's correlation coefficient of 0.587 suggests a positive relationship between these factors - p-value .000

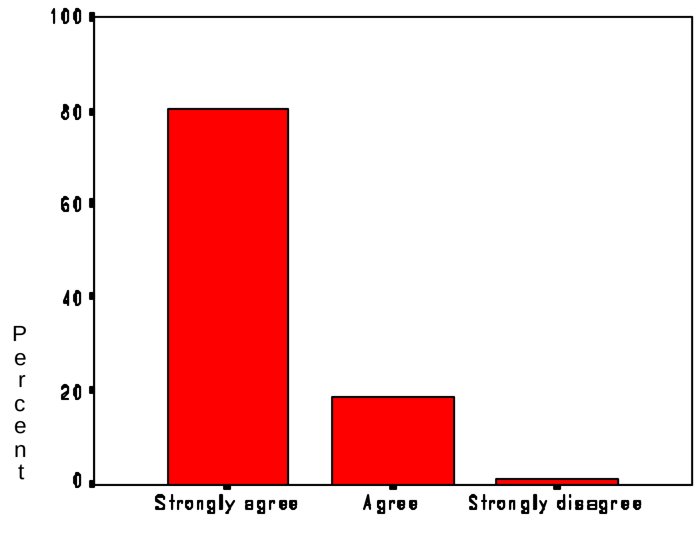
Reasons for using brokers

Figure 4: Why People Use Brokers[18]



Respondents were asked to rate (from 1-strongly agree to 7-strongly disagree) the reasons they believe people use mortgage brokers, with responses illustrated in Figure 4. Respondents rated all reasons, except access to more lenient credit policies, as significant. The most significant reasons that brokers believed they are used (in order of importance) were: convenience, wider range of options, and their impartiality (brokers will find the best deal).

Figure 5: Importance of Impartiality



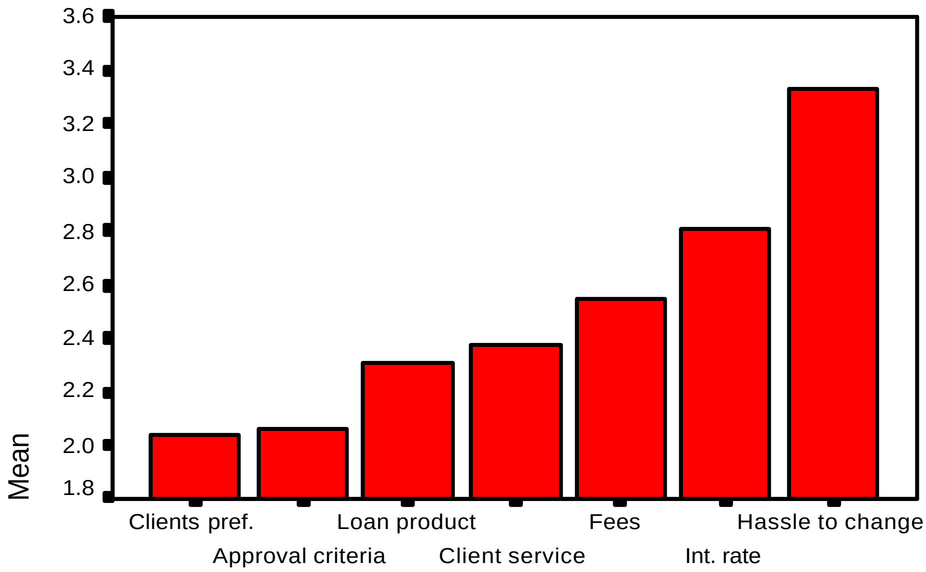
[18] Lower median means greater significance

When asked how strongly they agreed or disagreed with the statement "as a mortgage broker I believe that I must offer the client the best deal and therefore be totally impartial", almost all brokers agreed (98.9%), and most brokers (80%) strongly agreed, as shown in Figure 5. Although there is an obvious degree of social desirability to this question, it points strongly to brokers wanting to be viewed as impartial and offering the client the best deal.

Factors that influence a broker in lender selection

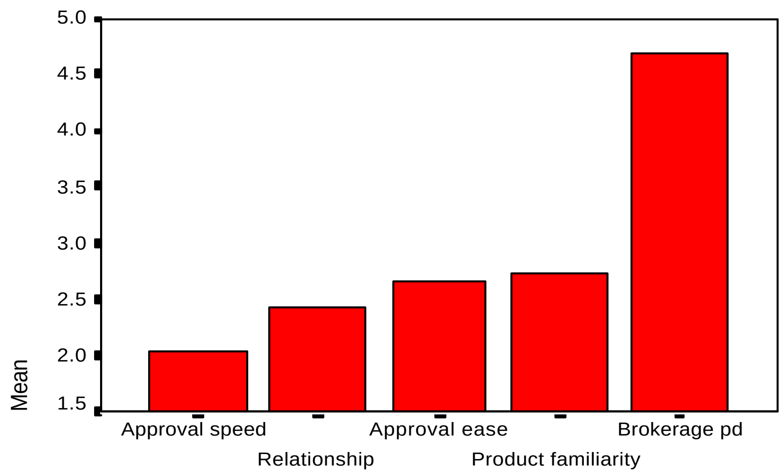
Brokers were asked to rate (from 1-very important to 7-very unimportant) 12 factors that influenced them in selecting a lender for their client. These included seven items that were based on the client, such as interest rates and the hassle to change, and five items based around factors that benefited the broker, such as ease of approval and level of brokerage. The following figures (6 and 7) illustrate how respondents rated these factors.

Figure 6: Factors that Influence Lender Selection (Client Focused)[19]



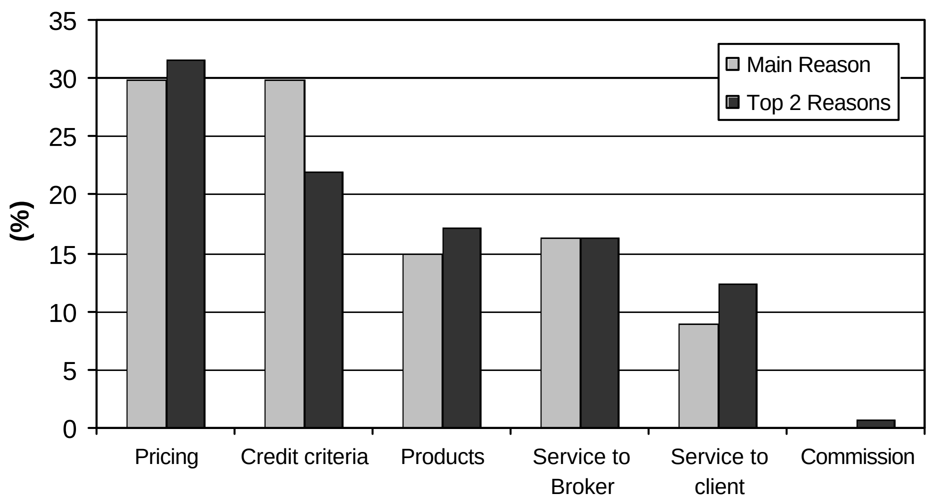
[19] The lower the mean, the more important the factor

Figure 7: Factors that Influence Lender Selection (Broker Focused)[23]



Respondents believed that all factors, except the client's "hassle to change", were important in influencing them in selecting a lender, with "the client's preference" and "flexibility of loan approval criteria" rating as most important. From the brokers' perspective all factors were rated by respondents as significant, except "the level of commission you receive from the lender". Overall results confirm that "client's preference of lender" rated as the most significant factor.

Figure 8: Reasons for Referring

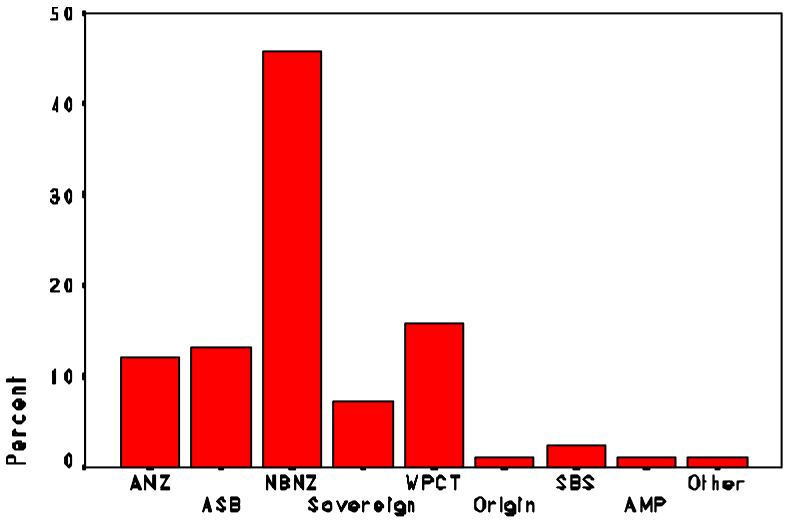


Respondents were asked to think of the lender that they had referred the most business to over the previous 12 months and then rank the reasons why this lender received most of their business (from 1-most important to 6-least important).

Best pricing options and credit criteria not being prohibitive were ranked as the main reason most frequently (29.9%), and pricing also ranked in the brokers top two reasons most frequently

(31.6%). These results confirm the reliance that brokers place on the lender's credit criteria and loan pricing. It is interesting to note that pricing has featured higher in this question than in Figure 7. This may provide some insight into an anomaly between how brokers think they operate and how they actually operate, although commission is still reported as insignificant.

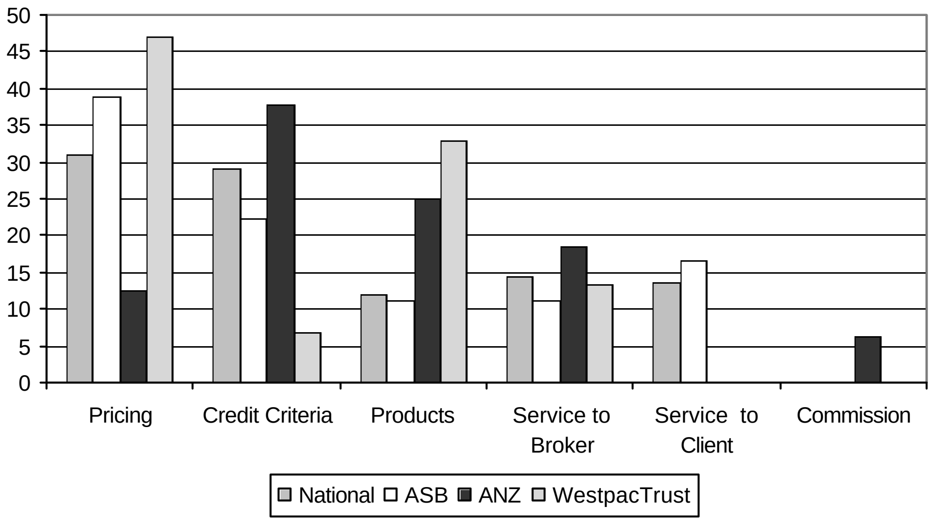
Figure 9: Lenders Ranked First in Past Year



Note: The small number of cases for each lender (e.g., 67 National Bank, 18 ASB, 15 WestpacTrust, 16 ANZ) may limit the scope to generalise from the survey results.

Figure 9 illustrates which lenders are receiving mortgage broker business. The National Bank was clearly the most favoured lender.

Figure 10: Main Two Reasons Why Major Lenders Received Business



Comparing the reasons given for referring business to banks shows the four main banks having different strengths[20]. For WestpacTrust, the best pricing options for clients and the products and services offered received the highest rankings. For ASB and National Bank, best pricing options were also the most important, but non-prohibitive credit criteria ranked next, and service to clients was also important. For the ANZ, non-prohibitive credit criteria was the most important reason, then the products and services offered. Service to brokers was ranked approximately equally for the four banks, and commission was included in the top two reasons by only one respondent.

[20] Only four New Zealand banks have been used (National Bank, WestpacTrust, ASB and ANZ) due to the low number of responses on the other lenders, thus preventing meaningful discussion on other New Zealand lenders.

DISCUSSION

Decision-making factors

Brokers were asked to rate the factors they deemed important in the decision making process (refer Figure 6 and 7). Their responses supported previous research, placing factors such as loan approval speed, approval criteria, approval ease, and the service provided to the client and the broker, ahead of interest rates, fees and brokerage paid. One reason for this could be that lenders price loans and commission payments to brokers similarly. These "financial" factors would, therefore, become less significant in the selection process than the "service" factors.

Contradictions about the importance of decision factors emerged in the findings. When respondents were asked to say why they had referred business to their most preferred lender in the previous year, they rated loan pricing and credit criteria well ahead of service to them and their clients. This suggests that to better understand the factors important to brokers one must understand why certain New Zealand lenders receive business from brokers. An analysis of why brokers referred business to a lender in the previous 12 months may provide a more accurate explanation of how brokers operate in practice, rather than how they think they operate (or would like to operate).

Pricing

Respondents rated both interest rates and application fees below many other factors, yet when assessing the main reasons why brokers actually referred business to their preferred lender, pricing was rated first. This suggests a conflict between the stated levels of importance that brokers place on pricing and how they actually operate.

Three of the four main lenders had pricing as one of two main reasons for brokers referring business to them over the previous 12 months. Although pricing is viewed by brokers as being a key reason for referring business, similarities in pricing between the lenders makes this factor less significant. On 14 October 2001, all five main New Zealand banks advertised the same floating interest rates (7.2% p.a.); with only one basis point separating these lenders' 12 month fixed interest rates (6.5%)[21].

[21] Brokers are at times able to receive lower interest rates for their clients than those advertised. For example, ASB provides 'preferred' brokers with a 25 basis point reduction in the variable rate for two years, WestpacTrust offers clients of their 'RedPac' loan product discounts in the fixed rates of up to 20 basis points. Banks will also discount rates on a case-by-case basis to retain or procure 'quality' business, or to build relationships with key brokers.

Evidence from Australia indicates that consumers are sensitive to a 25 basis point differential on home loan interest rates (Salomon Smith Barney, 2001, p.25). The reasons for this interest rate similarity include: 1) lenders funding mortgages from the same marketplace; 2) lenders with similar operating costs needing to maintain similar margins to ensure adequate returns on equity; and 3) because of marketplace transparency, lenders will lose business should they fall "out-of-step" with their competitors.

All New Zealand lenders had been extremely aggressive regarding loan pricing over the 12 months prior to the study. Westpac have received good volumes of business through their "RedPac" home loans; National Bank have offered lower interest rates on products such as their revolving credit facility; and ASB, among others, have waived application fees and occasionally contributed money towards solicitor costs in bids to attract business.

The research findings in this paper uphold previous research views, that loan pricing is an important consideration to brokers.

Credit

Brokers were asked how they perceived approval criteria and approval speed, and both of these factors were rated above all other decision factors apart from the client's preference of lender. When assessing the main reasons why brokers actually referred business to their preferred lender last year, credit criteria were rated as one of the two main reasons, so there was no significant difference between the stated levels of importance brokers place on credit criteria and the level of importance in practice.

Over one-third (38%) of brokers that favoured ANZ ranked that bank's credit criteria as one of the two main reasons for referring business to them. The ANZ's loan qualification criteria allowed loan applications falling outside other lenders' parameters to be approved. Examples of their "softer" criteria included allowing higher loan-to-value (LVR) lending against sale and purchase agreements, and use of a debt servicing calculation which was not as prohibitive to lower income applicants as other lenders' methods. Respondents also ranked credit criteria as the second most important reason for referring business to the National Bank, perhaps due to their aggressive marketing to the 95% LVR market.

Loan Products

Loan products were rated by brokers as the third most important decision factor when selecting a lender, behind approval criteria and client's preference. When assessing the main reasons why brokers actually referred business to their 'preferred lender' last year, loan products were rated behind pricing, credit criteria and service to brokers (Figure 10).

From the brokers that ranked WestpacTrust as their most preferred lender, 33% ranked their products and services as the most, or second to most, important reason for referring business to them. This percentage is well above ASB and National Bank who received 11% and 12% respectively for this factor. The difference may be attributed to the packaging and marketing of WestpacTrust's loan products, such as, their RedPac and state sector lending packages.

Service to brokers

Service to brokers (approval speed, relationship and approval ease) was rated as an important decision factor for selecting a lender, consistent with the way brokers rated this factor when referring business to their preferred lender.

A greater percentage of brokers had ranked ANZ as their number one lender, and brokers ranked service from the ANZ higher than the other three main lenders. The banks that chose to use centralised broker units[22] (Westpac, National Bank, and ANZ) did not appear to be disadvantaged in the level of service provided to brokers, particularly in comparison with ASB that manages each broker relationship through its branch network[23].

While the findings make it difficult to determine which lender is perceived by brokers to provide the best service, it remains apparent that brokers take many factors into account. For instance, there was a weak correlation between the broker's relationship with the lender and the level of brokerage received from that lender[24].

Many respondents viewed the relationship they have with the lender as an important factor. Those lenders that possess quality staff, give personal service and have an ability to "make a deal work" are at a distinct advantage over other lenders.

[22] These are business units set up by lenders to approve and process loan applications from brokers and to liaise and market to the mortgage brokers.

[23] Banks that choose to use a centralised unit suggest benefits such as reduced staff overhead, a better understanding of what is happening in the broker network, a faster speed of response, and more effective centralised marketing. Banks such as ASB believe that a face-to-face relationship between the broker/bank/client creates added service and loyalty.

Technology will play an increasing role in the delivery of service to brokers in the future. Many mortgage brokers already have access to lenders' web sites, clients' current loan information, and access to web-browsers that can quickly approve the loan. For example, Adelaide Bank can approve loans in 1.5 minutes subject to paper confirmation. In Australia it is anticipated that selected brokers will soon have the ability to process loans directly[25]. This may mean that in future brokers will only need to communicate with lenders directly when a loan request falls outside prescribed parameters.

Service to clients

Brokers viewed client service as important when selecting a lender, although this ranked well behind the other reasons (except commission) when assessing why brokers referred business to their 'preferred lender'. This indicates that respondents did not view client service as a significant factor in lender selection. Of the four main banks, only ASB (16.7%) and National Bank (13.5%) had client service identified as one of the two reasons brokers referred business to them in the previous twelve months, in line with previous studies on bank customer service (Staff, 2000, and Colgate and Lang, 2000), which ranked these two banks well ahead of Westpac Trust and ANZ.

Commission to brokers

Brokers did not identify high brokerage commission levels as important in influencing lender selection (Figure 6), which matched their reason for referring business to their preferred lender (Figure 8). Although brokers have indicated that commission levels are not important, the question remains as to why several lenders have implemented trailer commissions, at greater cost, if commission levels were not viewed as important by the brokers.

Previous research indicates that commission levels have a small part in brokers' decision-making, due to the similarities in commission structures amongst lenders. In New Zealand, however, differences in commission levels between major lenders are more marked. Brokers are therefore faced with the dilemma of deciding whether to refer business to a lender that may pay them less but be more suitable to the client, or one that will pay them more but be less appropriate for the client.

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[24] Pearson's correlation coefficient of 0.361 suggests a relationship between these factors, p-value .000

The ANZ experience provides an interesting case. In 1999, ANZ was the only New Zealand bank to offer trailer commissions to brokers and they received the largest share of their business from this channel than any other bank. In 2000, the National Bank and WestpacTrust instigated a similar commission structure and were rewarded with an increased share of business through brokers, whereas ANZ's percentage of business through this channel decreased slightly.

Anecdotal evidence suggests brokers are increasingly conscious of implications for their businesses of differences in lender commission levels which can have a significant difference on earnings.

Existing relationships

Most clients raising a home loan have an existing relationship with a bank or lender, yet respondents did not rate "hassle to change banks" as a significant factor in influencing lender selection. Current client banking relationships were taken into account by brokers when selecting a lender, and if the client is satisfied with their existing bank it is more likely that they will choose to remain with that bank, rather than sever existing connections[26]. Respondents' comments indicated they saw little sense in moving people to another lender if the client was happy with their existing bank and were not disadvantaged by staying there.

Hayward (1999) stated that 41% of broker clients were referred back to their existing bank. It can be deduced, therefore, that if existing relationships between the client and their current bank are amicable, the banks with higher numbers of existing client relationships will receive a larger amount of mortgage brokers' business. This assumption would, therefore, place the five major banks at a distinct advantage over their competitors[27].

How factors interrelate

This paper has stressed that brokers select a lender for their client based on a range of factors. The brokers' recommendation of a lender will depend on the client's and broker's needs. These dual needs may be based on what lenders offer in the way of pricing, credit criteria, loan products, service to broker and to client, commission to broker and the client's existing bank. The weight that brokers place on each factor, and how these factors interrelate, will determine

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[25] Discussions with an executive of a major New Zealand bank suggest that straight-through processing will not be far away in New Zealand.

[26] Most New Zealand banks provide fee rebates for home loan clients, therefore rewarding clients for having their home loan and transactional accounts together. Also, research by Matthews (2000b) confirms that clients are hesitant to change banks without significant incentive, due to the hassle of changing automatic payments, etc.

which lender is recommended. This is an imprecise and human process, and it is highly likely that one broker will weigh the factors differently to another.

One can identify lenders that place themselves in a strong position to secure future business from the broker channel and those that do not. To illustrate this, Table 2 has been designed to assess the five main New Zealand banks in terms of brokers' decision-making factors, and provide an overall rating. While not considered fully accurate, this table does provide some explanation as to why lenders are favoured over others. For instance, the National Bank receives consistently high scores in all factors, and is a convincing winner in this exercise. The rankings of the five lenders are consistent with their estimated rankings in market share of broker business.

This table assists in showing that brokers do not view one factor in isolation when choosing a lender, but consider a number of factors based upon what is important to them and their client. Therefore, a lender that rates consistently well in all factors (especially pricing and credit criteria) will be at a distinct advantage.

Table 2: Factor Comparisons of Main New Zealand Banks

		NBNZ		**ANZ**		**ASB**		**WPT**		**BNZ**	
Factor	Weight	Score	Total	Score	Total	Score	Total	Score	Total	Score	Total
Pricing	25%	90	22.5	90	22.5	90	22.5	90	22.5	80	20
Credit Criteria	25%	85	21.3	90	22.5	80	20	80	20	75	18.8
Products	10%	85	8.5	80	8	85	8.5	90	9	75	7.5
Service to Broker	10%	85	8.5	75	7.5	85	8.5	80	8	50	5
Service to Client	10%	80	8	55	5.5	85	8.5	60	6	70	7
Commission	10%	70	7	100	10	43	4.3	83	8.3	43	4.3
Existing clients	10%	80	8	43	4.25	73	7.3	57	5.7	48	4.8
TOTAL SCORE			**83.8**		**80.3**		**79.6**		**79. 5**		**67.4**

Explanations of Table 2 and calculations:

Alongside each decision factor a score (out of 100) is provided for each bank, based upon the research findings and anecdotal evidence. These scores illustrate how brokers may interpret various lender offerings: they are only assessments rather than any sort of accurate ranking. The

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[27] Market share figures for residential mortgages amongst New Zealand's five main banks as at 30 June 2001 were

scores are weighted according to their importance, with a 25% weighting used for the two factors deemed very significant to the broker, and a 10% weighting for other factors.

Pricing is very similar for the five banks, with National Bank, ASB, WestpacTrust, and ANZ rated equally. BNZ receives a lower rating due to their unwillingness to offer the Global Plus home loan through brokers, and a reluctance to shade interest rates and discount application fees.

Credit criteria represents the estimated ease of approval. Brokers spoken with indicated that these scores were "reasonably representative" of the various banks' stances on approval criteria.

Products represents the appeal of loan products. Most New Zealand banks have similar product ranges, which is represented in the range of scores (between 80 and 90). Brokers spoken with suggest that WestpacTrust rates slightly ahead of National Bank and ASB in this area, for its RedPac package[28]. National Bank and ASB have similar product appeal, and ANZ is viewed less favourably in this area. Although the BNZ has a similar product range to the other banks, it received a lower score due to their restriction on products offered to broker referred clients.

Service to broker scores places National Bank and ASB as the best providers of service to brokers, with WestpacTrust next, followed by ANZ and BNZ. Service provided to the brokers is similar to that provided to the banks' clients (except for BNZ who is rated lower by brokers).

Service to client scores are taken from a Consumer's Institute report on customer satisfaction.

Commission scores are based on average commission (refer Appendix 1). The highest paying bank (ANZ) receives a score of 100, with the remainder scoring a percentage of this, based on their commission relative to the ANZ's.

Existing clients scores reflect the bank's existing market share of a bank impacting on the amount of business that a bank receives from brokers, although dissatisfied clients are less likely to remain with their existing bank. The score in this factor requires two calculations. First, the score provided was based upon each bank's share of the New Zealand mortgage market. The bank with the highest market share (National Bank) received a score of 100, with the other banks

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National Bank (22.1%), WestpacTrust (21.1), ASB (19.3%), ANZ (16.8) and BNZ (15.3%).

[28] RedPac is a home loan package offered to clients when the loan amount exceeds $150,000. This package provides benefits such as discounted lending rates and lower insurance premiums.

receiving a score derived from their market share relative to National Bank's. The market share scores were then scaled by the client service scores used in the service to client calculations.

Protection of users of mortgage brokers

Mortgage brokers operate in an unregulated industry; many therefore believe that being seen as professional and independent is crucial to their growth and success. Brokers recognise that their functions, and the benefits of using them, are not fully understood by the general public. This may, therefore, allow unprofessional or unethical operators to damage the industry.

Consequently, an increasingly large percentage of the industry is endeavouring to regulate itself, through encouraging membership of the New Zealand Mortgage Brokers Association (NZMBA). Membership of the NZMBA allows the Association to ensure that a code of conduct is adhered to by members, thus protecting the image of Association members and the industry. Feedback from brokers and lenders suggest that the Association is applying pressure on lenders for them not to deal with mortgage brokers who are not members of the Association. This is an attempt by the NZMBA to become the official regulatory body for the industry.

There is currently no requirement for brokers to disclose the amount of commission they receive from lenders. It is considered that this is a payment made by the lender to the broker, and is not a direct cost to the client. Rob Tucker (Chairperson of the NZMBA) said that he did not see this as necessary "because all lenders pay similar commissions". However, as can be seen in Table 2 commission may play a large part in determining which lender a broker places a loan with. To ensure that clients are not "duped" by being placed with the lender that pays the highest commission, rather being placed with the lender with the 'best deal' it is recommended that the commission payable by each lender to that broker be disclosed to the client, with the other information about the lender.

CONCLUSIONS

The objectives of this research and the findings associated with each follow:

Objective 1: *To ascertain the most significant factors mortgage brokers consider when choosing a bank.*
The findings show that many different factors contribute to brokers' decision-making when selecting a lender for their clients. Brokers will be most likely to place the needs of their client before their own needs, as they view the need to be impartial and work in the client's best interests as very important.

Brokers view the pricing of the loan product as their most significant reason for referring business. However, due to the similarities between lenders, this factor does not prove to be a key differentiator. Credit criteria used by lenders are also seen as a major factor when deciding which lender a broker chooses, although this is only significant when a client is of lesser quality.

Given the similarities between lenders in price, credit criteria and lending products, brokers will tend to favour those lenders that create the strongest relationship with them and provide the best 'overall' service to them and their clients. Brokers will also tend to refer business back to the client's existing bank to prevent time consuming re-establishment of relationships elsewhere. This assumes the client is satisfied with the current level of service received from their bank. Although commission to brokers was not identified as a significant factor, both lenders and brokers acknowledge that the rate of commission is too important to ignore.

Objective 2: *To determine the relationship between the decision-making factors and how they inter-relate within the decision-making process.*
This study has identified the main factors that brokers consider in their decision process and has highlighted relationships between many of these factors. The study also confirmed why some New Zealand lenders achieve more support from brokers than others. This points to a need to score consistently well in many factors in order to be successful.

This study did not provide a scientific understanding of broker decision-making in practice and, therefore, some findings may appear to be based on how brokers would like to be seen to operate, rather than how they operate in practice.

Objective 3: *To ascertain whether mortgage brokers view their needs, such as profit motives, ahead of clients' needs, for example, loan pricing.*

Research findings would suggest that brokers view their clients' needs ahead of their own needs. Brokers recognise that they need to be viewed as independent and working to provide clients the best deal, and they are also conscious that the 'best deal' can be subjective, as pricing and other decision factors are normally similar. Brokers will, therefore, tend to place business with lenders that provide them with the best service, and provide competitive incentives.

Objective 4: *To begin discussion about whether new disclosure rules and regulations need to be introduced to protect users of mortgage brokers.*

Findings suggested that most brokers attempt to act in the client's best interest. However, due to the unregulated nature of the industry and the many different types of people calling themselves mortgage brokers, clients cannot be certain of the level of service and professionalism they receive. Nevertheless, with a majority of brokers now belonging to the New Zealand Mortgage Brokers Association, self-regulation is taking place. Clients who deal with member brokers will have more assurances of professionalism than those that deal with non-member brokers.

As many brokers receive varying commission levels from lenders, some clients may find that they are referred to lenders paying brokers higher commissions, and not the lender best suited. For the mortgage broking industry to be considered impartial and independent they must acknowledge that varying commission levels are incentives used by lenders to procure business. To ensure that the mortgage broker industry is seen as impartial it is recommended that brokers be pragmatic and either state the differences in commission levels to their clients; or, as some mortgage broking firms do, pay the mortgage broker the same amount no matter the lender.

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APPENDIX I: PAYMENT SCHEDULE TO BROKERS AS AT 1/10/01

New Zealand banks		Basis of payment
ASB	All	Upfront 0.65% of loan amount
ANZ	Small Broker <$1m referrals	1. >$50k Loan: $400 Upfront + 0.25% Trail 2. <$50k Loan: $150 Upfront + 0.25% Trail
	Large Broker (>$1m)	0.625% Upfront + 0.25% Trail
National Bank	Small Broker	0.75% Upfront
	(>$2m)	0.55% Upfront + 0.20% Trail
WestpacTrust	$1m-$5m	0.65% Upfront + 0.15% Trail
	>$5m	0.65% Upfront + 0.25% Trail
HSBC	All	Upfront 0.65%
BNZ	All	Upfront 0.65%