Statement of Issues

12 February 2020

AFG proposed acquisition of Connective

Purpose

1. Australian Finance Group Ltd (**AFG**) proposes to acquire Connective Group Pty Ltd (**Connective**). AFG and Connective are mortgage aggregators that act as intermediaries between mortgage brokers and lenders.

2. This Statement of Issues:

    - gives the preliminary views of the Australian Competition and Consumer Commission (**ACCC**) on competition issues arising from the proposed acquisition,
    - identifies areas of further inquiry, and
    - invites interested parties to submit comments and information to assist our assessment of the issues.

3. Statements of Issues do not refer to confidential information provided by the parties or other market participants and therefore may not fully articulate the ACCC's preliminary position.

Overview of ACCC's preliminary views

4. The legal test which the ACCC applies in considering the proposed acquisition is set out in section 50 of the *Competition and Consumer Act 2010*. In general terms, section 50 prohibits acquisitions that would have the effect, or be likely to have the effect, of substantially lessening competition in any market.

5. The ACCC divides its preliminary views into three categories, 'issues of concern', 'issues that may raise concerns' and 'issues unlikely to raise concerns'. In this Statement of Issues there are two 'issues of concerns', and one 'issue that may raise concerns'.

Issue of concern – reduced competition in the supply of mortgage aggregation services to brokers

6. The ACCC is concerned the proposed acquisition is likely to substantially lessen competition in the supply of mortgage aggregation services to mortgage brokers in Australia.

7. The proposed acquisition will combine the two largest mortgage aggregators in a market that is already concentrated with some significant barriers to entry. The ACCC's preliminary view is that the combined AFG-Connective will have the ability and incentive to reduce commissions payable to brokers, increase fees, or reduce service levels.

Issue of concern – reduced competition in the supply of mortgage distribution services

8. The ACCC is concerned the proposed acquisition is likely to substantially lessen competition in the supply of mortgage distribution services to lenders in Australia, particularly non-major lenders. The broker distribution channel is important for many lenders in selling loans. Therefore, having access to brokers (that are affiliated with aggregators) is critical. The combined AFG-Connective will have the highest number of affiliated mortgage brokers post-acquisition. In the absence of sufficient competitive constraints, the ACCC is concerned the combined AFG-Connective is likely to have the ability to raise costs and reduce service levels for lenders, especially non-major lenders.

Issue that may raise concerns – non-major lender foreclosure and reduced competition for the supply of home loans

9. AFG and Connective are both vertically integrated, each supplying home loans to consumers through affiliated brokers. This includes AFG supplying its own securitised products, and both AFG and Connective supplying their own branded products (also known as white-label products). The ACCC is concerned that the combined AFG-Connective will be able to leverage its strong position in mortgage distribution services into the supply of home loans and grow by foreclosing rival lenders. The ACCC is primarily concerned with the impact of foreclosure strategies on non-major lenders and how that may impact competition in the broader supply of home loans.

10. The combined AFG-Connective may have an increased ability and incentive to foreclosure rival non-major lenders by:

    - denying access to its panel,
    - raising costs or decreasing service levels, or
    - inducing affiliated brokers to recommend AFG-Connective branded products over competing loans.

11. The ACCC's preliminary view is that a combined AFG-Connective is likely to have the ability and incentive to foreclose rival non-major lenders. The ACCC is considering whether the foreclosure of non-major lenders may substantially lessen competition in the broader market for the supply of home loans to consumers.

Making a submission

12. The ACCC is seeking submissions from interested parties, particularly on the following key issues:

- the extent to which a combined AFG-Connective would be constrained from increasing or exercising its market power (e.g. by reducing commissions, increasing fees or decreasing service levels) in the supply of mortgage aggregation services to brokers, taking into account:
    - how closely specialist aggregators and franchise aggregators compete for brokers,
    - the ease with which brokers can switch aggregators, or may be able to do so post-merger,
    - the height of barriers to entry and expansion into the supply of mortgage aggregation services,
    - the extent to which lenders can supply home loans direct to consumers as an alternative to using a mortgage aggregation service,
- the extent to which a combined AFG-Connective would be constrained from increasing prices or decreasing service levels for lenders, and
- the extent to which a combined AFG-Connective would be constrained from foreclosing rival non-major lenders.

13. Detailed discussion of these and other issues, along with specific questions, is contained in this Statement of Issues.

14. Interested parties should provide submissions by no later than 5pm on 5 March 2020. Responses may be emailed to mergers@accc.gov.au with the title: Submission re: AFG/Connective - attention Morgan Woodland / Tash Venaik. If you would like to discuss the matter with ACCC officers over the telephone or in person, or have any questions about this Statement of Issues, please contact Morgan Woodland on 02 9230 9194 or Tash Venaik on 02 9102 4084.

15. The ACCC anticipates making a final decision on 7 May 2020, however, this timeline can change. To keep abreast of possible changes in relation to timing and to find relevant documents, interested parties should visit the Mergers Register on the ACCC's website at www.accc.gov.au/publicregisters/mergers-registers/public-informal-merger-reviews.

Confidentiality of submissions

16. The ACCC will not publish submissions regarding the proposed acquisition. We will not disclose submissions to third parties (except our advisors/consultants) unless compelled by law (for example, under freedom of information legislation or during court proceedings) or in accordance with s155AAA of the *Competition and Consumer Act 2010*. Where the ACCC is required to disclose confidential information, the ACCC will notify you in advance where possible so that you may have an opportunity to be heard. Therefore, if the information provided to the

ACCC is of a confidential nature, please indicate as such. Our *Informal Merger Review Process Guidelines* contain more information on confidentiality.

About ACCC 'Statements of Issues'

17. A Statement of Issues is not a final decision about a proposed acquisition. A Statement of Issues outlines the ACCC's preliminary views and identifies further lines of inquiry.

18. A Statement of Issues provides an opportunity for all interested parties (including customers, competitors, shareholders and other stakeholders) to ascertain and consider the primary issues identified by the ACCC. It is also intended to provide the merger parties and other interested parties with the basis for making further submissions should they consider it necessary.

Timeline

Date	Event
23 October 2019	ACCC commenced review of the proposed acquisition
9 December 2019	ACCC requested further information from the parties. Former provisional date for announcement of ACCC's findings (23 January 2020) is delayed.
14 January 2020	ACCC received information from the parties.
12 February 2020	ACCC publication of Statement of Issues
5 March 2020	Deadline for submissions from interested parties in response to this Statement of Issues
7 May 2020	Anticipated date for ACCC final decision

The parties

The acquirer – Australian Finance Group Ltd

19. AFG is an ASX listed mortgage aggregator, established in 1994. AFG has over 2,975 affiliated brokers across Australia, providing brokers with access to products from a panel of approximately 50 lenders.

20. The largest part of AFG's business is residential mortgage aggregation. However, AFG also offers its affiliated brokers aggregation services for commercial loan products, inventory finance, franchisee loans, debtor finance, commercial property finance, working capital finance and personal loans.

21. As part of its service offering to brokers, AFG provides support services to assist brokers to run their business, including the FLEX Customer Relationship Management (**CRM**) software platform, business managers, IT and marketing support, compliance officers and a dedicated call centre.

22. AFG also offers its own-branded residential mortgage products to customers of affiliated brokers under AFG Home Loans. This includes 'Edge' (funded by Advantedge, a National Australia Bank (**NAB**) entity), 'Alpha' (funded by Bendigo and Adelaide Bank), 'Options' (funded by Pepper Money) and 'Retro' and 'Link' (funded by AFG's own Securitisation program).[1]

The target – Connective Group Pty Ltd

23. Connective is a privately owned mortgage aggregator, established in 2003. Connective has approximately 3,600 affiliated brokers across Australia and provides them with access to loan products from a panel of over 60 lenders (both commercial and residential).

24. Residential mortgage aggregation is the largest part of Connective's business. However, Connective also offers affiliated brokers aggregation services for other consumer loans, including personal loans and car/boat loans, as well as commercial loans, including business finance and asset finance products.

25. As part of its service offering to brokers, Connective provides a range of support services to assist brokers to run their business, including the Mercury software platform, support and training on technical, business and compliance matters.

26. Connective also offers its own-branded loan products under its brand 'Connective Home Loan' through its Mercury CRM software platform to consumers of its affiliated brokers. This includes 'Essentials' (funded by Advantedge, a NAB-owned entity), 'Select' (funded by Bendigo and Adelaide Bank), and 'Solutions' funded by Pepper Money).[2]

Industry background

27. In buying residential property consumers often seek access to finance from authorised deposit-taking institutions (**ADIs**). ADIs include banks, credit unions and other financial service companies.

28. As demonstrated in **Figure 1** below, lenders generally distribute home loans via either:

    a. Direct channel: this involves a consumer directly engaging with the lender to arrange the home loan. The lender may assist the borrower in: determining which product is suitable for the borrower (from the products offered by that lender), preparing all of the necessary documentation, and assessing the borrowers' eligibility.

    b. Indirect intermediary channel: intermediaries facilitate the comparison and sale of loan products from a range of lenders. Brokers are the primary intermediary and are critical in the mortgage distribution supply chain. Currently, 55 per cent of total loans written are initiated through the broker channel.[3] Brokers assist customers in comparing products from a range of

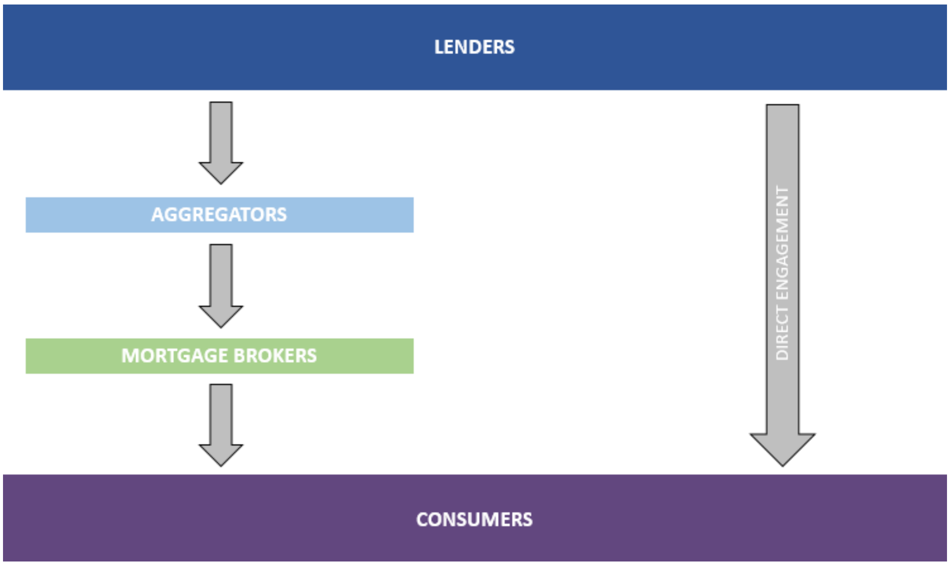
1 https://www.afghomeloans.com.au/home-loan-products/.

2 https://www.connectivehomeloans.com.au/loan-products-2/.

3 As at September 2019. Mortgage & Finance Association of Australia press release, 3 December 2019: https://www.mfaa.com.au/news/mortgage-broker-market-share-falls-jul-sept-2019-quarter.

lenders, preparing the application, and settling the loan. To facilitate the provision of these services to consumers, brokers will typically acquire the services of a mortgage aggregator (described in more detail below at paragraph 31).

Figure 1: Mortgage distribution supply chain



Lenders

29. Lenders in Australia include the 'big 4' banks, other banks with an Australian presence,[4] and neo-banks.[5]

30. Lenders typically target customers via both the direct and indirect intermediary channels. Generally, lenders do not enter into exclusive arrangements with aggregators and will typically sit on a number of aggregators' panels to maximise exposure of their products. The ACCC understands that brokers are particularly important for non-major lenders (outside the big 4 banks) to gain market share and compete with major lenders.

Mortgage aggregators

31. Mortgage aggregators (including AFG and Connective) act as an intermediary between brokers and lenders, providing brokers with access to a panel of lenders and a range of mortgage products, which they in turn recommend to customers.

32. As demonstrated in **Figure 2** below, aggregators have contractual agreements with the lenders on their panel, which allows their affiliated brokers to arrange loans from those lenders for their customers.

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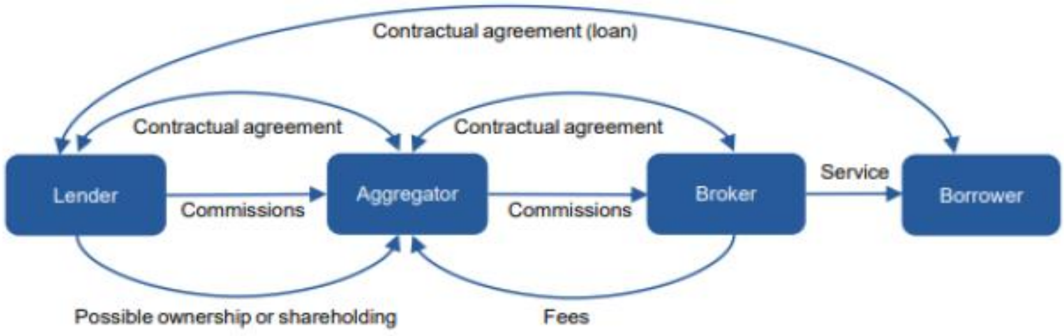
[4] For example, ING Bank, Bendigo and Adelaide Bank, Suncorp Bank and Macquarie Bank.

[5] For example, Judo Bank, Xinja and Volt Bank. Neo banks have no physical presence and are purely available online or via a smart phone app.

Figure 2: Indirect intermediary supply chain[6]



[a] This model outlines only business and contractual arrangements, and does not include the licensing regime outlined in the *National Consumer Credit Protection Act 2009* (Cth)

33. Mortgage aggregators offer a range of services to brokers to assist them with the running of their business, including:

- access to a panel of lenders. An aggregator may have anywhere between 15 to 60 lenders on their panel.[7]

- CRMs. CRMs are a critical aspect of an aggregator's service offering. A CRM is typically described as an 'end-to-end system for loan application,' providing brokers with the ability to compare products from the lender panel, a borrowing capacity calculator, and product criteria search and purchase and refinance scenario tools. A CRM may also provide marketing and compliance support systems, internal reporting functions and data security. CRMs are typically developed in-house by the aggregator, but can also be leased from a third party and customised.

- other services provided by mortgage aggregators include administrative support, use of the aggregator's Australian Credit Licence (**ACL**), lender information and training and professional development.

34. In Australia there are two types of mortgage aggregation business models:

- 'specialist' aggregators: brokers that are affiliated with a specialist aggregator trade under their own name but receive access to the aggregator's lender panel, CRM and ACL. Both AFG and Connective are specialist aggregators.

- franchise model aggregators: brokers that come under a franchise model aggregator will typically trade under the name of the franchise group, which provides the broker with the core services provided by specialist aggregators as well as other support services including training, marketing

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[6] Productivity Commission 2018, *Competition in the Australian Financial System*, Report no. 89, Canberra, p 304.

[7] If a lender is not on an aggregator's panel, a broker can still recommend customers a loan product from that lender if the broker obtains a direct accreditation with the off-panel lender. Requesting to go off-panel typically only occurs rarely, where the products available through an aggregators' panel fail to meet a particular client's needs.

and administration. For example, Aussie Home Loans and Mortgage Choice are franchise aggregators.[8]

35. As demonstrated in **Table 1**, there are some aggregators that offer both franchise and specialist models to mortgage brokers. For example, Loan Market, historically a franchise aggregator, recently introduced an initiative that allows a mortgage broker to join its network while retaining their personal brand.[9]

36. Within both the franchise and specialist business model categories, there are also bank-owned aggregators. For example, Aussie Home Loans (a franchise aggregator) is owned by Commonwealth Bank of Australia (**CBA**). Similarly, PLAN, FAST and Choice are owned by NAB.

Market concentration

37. **Table 1** on the next page contains the estimated market shares (based on affiliated broker numbers) of major aggregators in Australia.[10]

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[8] Some specialist aggregators also provide these ancillary support services, but the ACCC understands that the breadth of services that specialist aggregators provide is usually narrower than those provided by franchise aggregators.

[9] https://www.loanmarket.com.au/bringyourownbrand.

[10] The market share data for each aggregator by residential home loan settlements is largely consistent with the market share data of each aggregator by affiliated brokers.

Table 1: Aggregators in Australia and their estimated market shares (by affiliated broker numbers)

Aggregator	Business model	Number of affiliated brokers[11]	Market share by affiliated brokers
Connective	Specialist	3,600	21%
AFG	Specialist	2,975	18%
Combined AFG-Connective	Specialist	6,575	39%
PLAN (owned by NAB)	Specialist	1,600	10%
FAST (owned by NAB)	Specialist	1,300	8%
Choice (owned by NAB)	Specialist and Franchise	1,300	8%
Combined NAB owned aggregators	Specialist and Franchise	4,200	26%
Vow Financial / Yellow Brick Road	Specialist	1,250	7%
Aussie Home Loans (owned by CBA)	Franchise	1,000	6%
Finsure	Specialist	1,000	6%
Loan Market	Specialist and Franchise	500	3%
Mortgage Choice	Franchise	400	2%
Other aggregators[12]		~1,926	~11%
Total number of brokers[13]		16,851	100%

38. As shown in **Table 1** above, the supply of mortgage aggregation services in Australia is concentrated, with the five largest aggregators (AFG, Connective and the three NAB owned aggregators) having a combined market share of approximately 65 per cent. AFG and Connective are the largest mortgage aggregators and the proposed acquisition will increase AFG's market share by 21 per cent, and create the largest mortgage aggregator in Australia with a combined market share of 39 per cent based on the number of affiliated brokers.

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[11] Aggregator website. The ACCC understands that these are predominantly brokers writing residential loans but may also include brokers that write commercial and asset finance loans.

[12] Calculated by subtracting the number of mortgage brokers, as obtained from each aggregator's website, from the total number of brokers.

[13] Mortgage & Finance Association of Australia, *Industry Intelligence Service*, 8th edition, p 4.

Remuneration arrangements

39. The ACCC understands that lenders generally pay aggregators the full commission for loans originated by affiliated brokers, and aggregators distribute a proportion of the commission to their brokers.[14] The most common commission model for brokers and lenders comprises the following two components:

- an upfront commission which is usually calculated as a percentage of the drawn down loan amount (minus amounts in any linked offset accounts); and
- a trail commission which is a recurring payment, and is substantially lower than the upfront commission, calculated as a percentage of the outstanding loan balance over the life of the loan.

40. Market feedback has indicated that lenders generally determine the commission rates paid to aggregators and these rates tend not to be negotiated. Lenders will also sometimes provide sponsorship payments to aggregators in return for further broker exposure, such as participation in learning and development programmes.

41. Mortgage aggregators charge brokers a fee for the services they provide. The arrangements between aggregators and brokers regarding fees vary between aggregators. Aggregators will have one or both of the following:

- Commission sharing model: the aggregator will retain a proportion of the commission payments from lenders.
- Flat fee model: the broker will receive 100 per cent of the upfront and trail commission, but will pay a flat monthly fee to the aggregator in exchange for their services.

42. Connective offers both a flat fee model and commission sharing model. AFG offers a commission sharing model.

Sub-aggregators

43. In addition to aggregators, a number of sub-aggregators operate in Australia. Generally, sub-aggregators hold their own ACL and obtain access to an aggregator's lender panel, lender accreditation facilities and lease the required CRM technology. Sub-aggregation often involves the supply of mortgage aggregation services to a smaller pool of brokers.

Mortgage brokers

44. Mortgage brokers act as an intermediary by connecting borrowers to lenders, via aggregators. Mortgage brokers help customers select an appropriate loan, arrange documentation for loan applications, assist in negotiations with lenders and provide customers with guidance and support throughout the life of the loan.

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[14] Occasionally lenders may pay brokers directly, but this is not common industry practice.

45. As noted in paragraph 28, the broker distribution channel is the primary channel for many lenders to supply home loans.

46. Mortgage broking businesses have differing models, including:

- franchisor models: under this model, the franchisee broker will have the right to use the franchisor's business name and branded service.
- licensee models: under this model, brokers are employed or licensed by a single branded employer.
- broker groups: this involves a large number of brokers operating as a group to increase scale. These brokers are usually affiliated with specialist aggregators.
- own name brokers: brokers trading under their own brand name. These brokers are usually affiliated with specialist aggregators.
- small traders: brokers who operate with no group or broader affiliation.

Other industry participants

Fintechs

47. Fintechs (i.e. financial technology companies) use technological innovation to deliver financial services in new ways to customers which are often designed to be more tailored to individual needs or provided in a quicker or cheaper way.[15]

48. Some fintechs operate in the 'alternative lending space', for example, as a peer-to-peer (**P2P**) lender. P2P lending involves borrowing money without going through a traditional lender, instead going through an intermediary which links a borrower to an investor, which is either an individual or a company.

49. The ACCC is considering submissions made by the parties about the constraint that fintechs will impose on mortgage aggregators and does not have a concluded view on this point. Further information about the ACCC's consideration of this issue is provided below at paragraphs 109 to 110.

Comparison website providers

50. Comparison websites provide a platform for consumers to compare home loan products and prices, by providing subject metrics for lenders (including ratings and awards for products and providers).[16] They can assist consumers in determining which lenders to approach in the direct channel or to confirm brokers' recommendations in the intermediated channel. Lenders invest in and utilise comparison websites as a marketing tool.

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[15] An example of a fintech is Lendi, which is an online platform which searches home loan products from lenders and matches customers with certain lenders and products based on the customer's needs and characteristics. After being matched with a lender and product a customer can use the online platform to submit a home loan application, upload and verify documents, get approval and settle their loan.

[16] Comparison websites include Canstar, finder.com.au and InfoChoice.

Relevant inquiries and changes to the industry

51. The industry has been impacted, and may be further impacted, by a number of recent significant inquiries.[17] These inquiries have resulted in recommendations for legislative and regulatory reform which are in the process of being adopted. Such reforms are likely to impact industry participants in the next few years (including brokers, lenders and aggregators).

52. In addition, the introduction of the Consumer Data Right (**CDR**) is likely to impact the industry by giving consumers greater access to and control over their data. Consumer data relating to mortgage and personal loan data is expected to be able to be shared after 1 November 2020. The parties have submitted to the ACCC that Open Banking and the CDR will constrain a combined AFG-Connective as these reforms will make it easier for potential entrants or smaller players to obtain customer data and deliver bespoke financial products directly to customers. However, the extent of innovation and change that will result, the disruptiveness of that innovation, and the timing of that innovation, is unknown.

The proposed acquisition

53. On 12 August 2019, AFG announced to the ASX that it entered into a binding conditional implementation deed to merge with Connective. Under the transaction, Connective will receive $60 million in cash and 30,886,441 AFG shares valuing the acquisition at $120 million.[18]

Market definition

54. As stated in the ACCC's *Merger Guidelines,* the ACCC's starting point for defining relevant markets to assess the competitive effects of the proposed acquisition involves identifying the products actually or potentially supplied by the merger parties.[19] The ACCC then considers what other products or services constitute sufficiently close substitutes to provide a significant source of constraint on the combined AFG-Connective.

55. The key areas of overlap between AFG and Connective are:

- the supply of mortgage aggregation services to brokers in Australia,
- the supply of mortgage distribution services to lenders in Australia, and
- the supply of home loans to consumers in Australia through brokers.

56. Issues relating to substitution in the relevant markets are explored below.

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[17] These include the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, the Productivity Commission's Inquiry into Competition in the Australian Financial System, the ACCC's Residential Mortgage Price Inquiry and the Home Loan Price Inquiry, as well as a number of other ASIC inquiries (mainly around mortgage brokers and customers' experiences in getting home loans).

[18] https://www.afgonline.com.au/corporate/afg-news/afg-and-connective-announce-merger/

[19] ACCC, *Merger Guidelines 2008* (updated 2017), paragraph 5.17.

57. For each relevant market, the ACCC considers the geographic scope is likely to be national.

Market for the supply of mortgage aggregation services to brokers

58. The ACCC's preliminary view is that there is a market for the supply of mortgage aggregation services to brokers. This market is likely to include both specialist aggregators as well as franchise aggregators. Details about these types of aggregators is provided above in paragraph 34.

59. The ACCC recognises that although there are some differences in the breadth and types of services offered by franchise aggregators and specialist aggregators, they essentially serve the same functional purpose of intermediating between brokers and lenders. In that regard, they are likely to be considered substitutes from the perspective of brokers. The ACCC understands that brokers can and do switch between franchise and specialist aggregators in both directions.

60. As discussed below, the ACCC considers that specialist aggregators are likely to compete more closely with each other than with franchise aggregators.

The ACCC invites comments from market participants on its preliminary views about the definition of the relevant markets. In particular market participants may wish to comment on the following:

- If you are a broker, what aggregators did you consider joining when you entered the industry? During this decision, what factors prompted you to choose the aggregator you are currently with over the other options you considered? How important was the franchise/specialist characteristic of the aggregator to that decision?
- If you are a broker, what factors or events would prompt you to switch from a franchise aggregator to a specialist aggregator, or from a specialist aggregator to a franchise aggregator?
- If you are a broker and have switched aggregators, what aggregators did you consider joining when you last switched aggregators (and which aggregator did you switch from)? In making this decision, what factors prompted you to choose the aggregator you are currently with over the other options? How important was the franchise/specialist characteristic of the aggregator to that decision?

Market for the supply of mortgage distribution services to lenders

61. The ACCC's preliminary view is that there is a market for the supply of mortgage distribution services to lenders in Australia.

62. As set out above in paragraph 28, lenders generally distribute loans through the indirect intermediary channel (broker channel), or directly to a customer (direct channel).

63. Market participants have indicated that the broker channel is critical for a lenders' distribution of loans, as the demand for a broker originates from customers. Market feedback has suggested that customers who use brokers generally require and seek a higher level of advice, support and assistance as opposed to those going through the direct channel. These customers are highly unlikely to use the direct channel, particularly due to increasing regulation and

reform in the industry that has introduced complexity for customers wishing to take out a mortgage.

64. As such, an increase in prices in mortgage distribution services from aggregators, would be unlikely to result in a lender switching to sell a large proportion of loans through the direct channel, as consumers will continue to demand the provision of loans through the broker channel.

The ACCC invites comments from market participants on its preliminary views about the definition of the relevant markets. In particular market participants may wish to comment on the following:

- If you are a lender, is the indirect intermediary channel important to your business? What percentage of residential loans are written through brokers?
- If you are a lender, have you attempted to grow the direct channel? Are there any impediments in growing your direct channel? If so, what are those impediments?
- Are there any benefits for customers to going through the direct channel?

Market for the supply of home loans to consumers in Australia

65. The ACCC's preliminary view is that there is a market for the supply of home loans to consumers in Australia.

66. As noted above, AFG and Connective are vertically integrated, in that they both supply their own home loans to consumers through their affiliated brokers. AFG and Connective supply their own-branded offerings funded by other lenders and AFG also sells its own securitised products.

Other areas of overlap

67. Other relevant markets in which AFG and Connective overlap in include:

    - Commercial loan distribution (aggregation) services,
    - Asset finance loan distribution (aggregation) services, and
    - Insurance referral services.

68. AFG and Connective are relatively small players in these areas. Market feedback has not indicated concerns from the proposed acquisition in these markets, and the ACCC considers these other areas of overlap are unlikely to raise competition concerns.

The ACCC invites comments from market participants on its preliminary views about whether the combined AFG-Connective will be unlikely to substantially lessen competition in the supply of:

- Commercial loan distribution services to lenders and aggregation services to brokers.
- Asset finance distribution services to lenders and aggregation services to brokers.
- Insurance referral services.

Issue of concern: reduced competition in the supply of mortgage aggregation services to brokers

69. The ACCC's preliminary view is that the proposed acquisition is likely to substantially lessen competition in the supply of mortgage aggregation services to brokers.

70. The proposed acquisition will increase concentration in mortgage aggregation services and create (by far) the largest mortgage aggregator in Australia. The ACCC's preliminary view is that as close competitors, AFG and Connective are likely to currently constrain each other. The removal of Connective as an independent market participant in a market with some significant barriers to entry and expansion is likely to increase the ability and incentive for the combined AFG-Connective to reduce commissions payable to brokers, increase fees or reduce service levels.

Closeness of competition between AFG, Connective and other mortgage aggregators

71. The ACCC is considering the extent to which remaining aggregators will provide a competitive constraint on the combined AFG-Connective post-acquisition. In particular, the ACCC is considering the closeness of competition between AFG, Connective and other aggregators.

72. As noted in paragraph 34, aggregators may operate as either a franchise aggregator or a specialist aggregator. They may or may not also be bank-owned.

73. Market feedback indicates that specialist aggregators compete more closely with each other than with franchise aggregators. This is largely due to certain differences in the breadth and type of services that each of these types of aggregators provide brokers, and whether brokers want to run a business under their own brand or the brand of the aggregator. As noted in paragraph 34, franchise aggregators usually have a high support, full service offering and specialist aggregators tend to offer a narrower suite of services to brokers.

74. As a result of these differences, the characteristics of brokers that are affiliated with specialist aggregators tend to differ from brokers that use franchise model aggregators. Brokers' preference for one type of aggregator over the other also tends to depend on their stage of career and the level of support they require. Franchise aggregators like Mortgage Choice and Aussie Home Loans may not impose a strong constraint on specialist aggregators like AFG and Connective, as many experienced brokers that desire the independence and lower support associated with a specialist aggregator would not consider a franchise aggregator to be the most suitable or closest alternative.

75. Some market participants also indicated that bank-owned aggregators might not compete closely with non-bank owned aggregators for the same brokers. Some brokers indicated that they valued the independence of non-bank owned aggregators and wanted to avoid the overall perception of being associated with one of the major banks (e.g. CBA or NAB). Accordingly, bank-owned aggregators like PLAN, FAST and Choice may not impose a strong constraint on specialist aggregators like AFG and Connective.

76. Accordingly, the ACCC's preliminary view is that non-bank owned specialist aggregators (like AFG and Connective) compete more closely with each other than with franchise aggregators or bank-owned aggregators. The ACCC considers that although there are differences in AFG and Connective's precise service offering and remuneration structures, AFG and Connective compete more closely with one another than they do with franchise or bank-owned aggregators.

77. The ACCC recognises there are other non-bank owned specialist aggregators, such as Finsure, Vow and Specialist Finance Group. The ACCC considers that these other specialist non-bank owned aggregators are not of a size comparable to AFG and Connective and are unlikely to competitively constrain the combined AFG-Connective.

78. However, the ACCC understands there may be scope for franchise aggregators to broaden their offering to potentially compete more closely with AFG and Connective. For example, Loan Market (a franchise aggregator) recently introduced an offering which allows brokers to join and receive the full suite of services without using the Loan Market brand (i.e. a "bring your own brand" arrangement).[20]

79. Accordingly, the ACCC's preliminary view is that AFG and Connective are close competitors that exert a significant degree of competitive constraint on each other. AFG and Connective compete particularly closely to attract brokers seeking independence and wishing to avoid the affiliation with a franchise brand or a bank. The ACCC is concerned that remaining mortgage aggregators (particularly the franchise and bank-owned aggregators) may not impose an adequate constraint on the combined AFG-Connective.

The ACCC invites comments from market participants on its views with respect to rival aggregators and the closeness of competition between AFG and Connective. In particular market participants may wish to comment on the following:

- How closely do AFG and Connective compete with each other and other aggregators (including specialist aggregators, franchise aggregators and bank-owned aggregators)? Do they compete differently for brokers who are new to industry, compared to experienced brokers?

- How closely do specialist aggregators compete with franchise aggregators? Do they compete differently for brokers who are new to industry, compared to experienced brokers? Do brokers switch frequently between specialist aggregators and franchise aggregators? What factors would prompt such switching?

- Do bank-owned aggregators compete with non-bank owned aggregators? What is the general perception that brokers have of bank-owned aggregators?

- When considering the closeness of competition between AFG, Connective and rival aggregators you may wish to also consider the questions listed after paragraph 60.

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20 https://www.loanmarket.com.au/bringyourownbrand.

Connective as a vigorous and effective competitor

80. The ACCC is considering whether Connective's historical behaviour and growth are characteristics of a vigorous and effective competitor.

81. The ACCC's *Merger Guidelines* note that vigorous and effective competitors may drive significant aspects of competition such as pricing, innovation and product development. Acquisitions involving such a market participant are more likely to result in a significant and sustainable increase in the combined entity's unilateral market power.[21]

82. The ACCC understands that since its organic entry into mortgage aggregation services in 2003, Connective has gained popularity with brokers and established itself as a market leader. Market participants noted that its strong growth is attributable to its flat fee model (which when introduced, was the first of its kind), and its market leading Mercury CRM platform. Several broker market participants identified Connective's CRM as the key reason for choosing it over another aggregator.

83. The ACCC considers that Connective's strong CRM platform may be the result of it devoting resources to innovating and improving this platform, and this is also likely to have prompted competing aggregators to similarly invest in platform improvements to remain competitive.

84. The ACCC considers that there is some likelihood that the removal of Connective as an independent market participant may remove an important driving force for innovation in the market by reducing the incentive for competing aggregators to continually invest in and improve their CRM platforms. The ACCC has not reached a concluded view on this point.

The ACCC invites comments from market participants on whether Connective possesses characteristics of a vigorous and effective competitor. In particular market participants may wish to comment on the following:

- What aspects of Connective's service offering are unique or particularly competitive?

- Has Connective demonstrated a greater degree of innovation and investment in improvements to its CRM platform (relative to other aggregators)?

- Would the removal of Connective as an independent market participant alter the incentives of other competitors to invest in improvements to their CRM platforms?

Barriers to entry and expansion

85. The ACCC is considering the extent to which new or potential entry and/or expansion is likely to act as a constraint.

86. The entry of new firms into a market can provide an important source of competitive constraint on incumbents.[22] A credible threat of new entry alone may

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[21] ACCC, *Merger Guidelines 2008* (updated 2017), paragraph 7.56.
[22] ACCC, *Merger Guidelines 2008* (updated 2017), paragraph 7.17.

prevent any attempt to exercise market power in the first place. On the other hand, where a market has barriers to entry that either prevent firms from entering the market altogether or delay or impede entry, that may result in the combined entity being sheltered from competitive constraint for a significant period.[23]

87. The ACCC understands that there are several steps that a prospective entrant needs to take in order to commence supplying mortgage aggregation services to brokers or mortgage distribution services to lenders. These include establishing a regulatory and compliance framework (including obtaining an ACL).

88. New entrants would also need to enter into contracts with a panel of lenders, which may be time consuming as lenders typically undertake significant inquiries into aggregators' businesses before agreeing to be on their panels.

89. The ACCC's preliminary view is that although the steps noted above may be time consuming and involve costs, they would be unlikely to materially impede entry. However, market feedback indicates that there are a number of more significant factors or barriers that may inhibit entry as a mortgage aggregator. The ACCC also considers that due to these barriers, expansion to a scale sufficient to compete with a merged AFG-Connective is unlikely. These barriers to entry and/or expansion include:

    - costs and time associated with investing in or leasing / licensing a good quality CRM, which allows brokers to assess, record and submit applications for customers to lenders,
    - the current climate of regulatory uncertainty as well as new and incoming regulation which raises compliance costs,
    - the difficulties in establishing an adequate pool of brokers, including as a result of broker switching constraints,
    - scale, which is necessary for entry to be financially viable, and
    - network effects arising from the combined AFG-Connective having a large pool of brokers.

90. These barriers to entry are discussed below.

91. As stated in the ACCC's *Merger Guidelines*, the ability of rivals to expand depends on the existence of any features of the market that either prevent firms from expanding altogether or delay or impede expansion to such a degree that rivals are unable to expand in an appropriate time to defer or defeat any non-transitory exercise of increased market power by the merged firm.[24]

92. The ACCC's preliminary view is that in addition to some of the barriers to entry mentioned above, a key barrier to expansion is winning existing brokers from rival aggregators. This is discussed further below with respect to broker 'stickiness'.

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[23] ACCC, *Merger Guidelines 2008* (updated 2017), paragraph 7.17.
[24] ACCC, *Merger Guidelines 2008* (updated 2017), paragraph 7.44.

93. Despite these barriers to entry and expansion, the ACCC notes that Connective entered as a mortgage aggregator in 2003 and has achieved significant growth since (as noted as paragraph 82). The ACCC also notes that Finsure entered mortgage aggregation in 2011 and has experienced growth in its broker numbers in the past few years.

94. The ACCC is also considering the barriers to entry associated with becoming a sub-aggregator. In particular, the ACCC is considering whether it would be easier for a prospective entrant to first establish itself as a sub-aggregator and develop relationships with brokers and then subsequently transition to becoming an aggregator in its own right.

Investment in a good quality CRM

95. As noted in paragraph 33, an aggregator's CRM is a core part of its overall service offering to brokers, and is accordingly a critical piece of infrastructure that an aggregator needs to invest in.

96. The ACCC understands that the costs of developing a CRM in-house may be significant. Market participants noted that as an alternative, an aggregator can also lease or licence a CRM platform from a third party provider. The ACCC's preliminary view is that this is likely to be cheaper and less time consuming than developing a CRM from scratch.

97. However, the ACCC is considering whether an off-the-shelf customised CRM is a viable alternative for aggregators. The ACCC's preliminary view is that it might be difficult to customise an off-the-shelf licensed or leased CRM to the extent necessary to ensure that it provides all the relevant functions of a high quality competitive CRM that is developed from scratch.

Climate of regulatory uncertainty and new regulation

98. As noted above in paragraph 51, the ACCC understands that recent significant inquiries into the financial services industry (most notably the Productivity Commission's Inquiry into Competition in the Australian Financial System and the Royal Commission) have contributed to a current climate of regulatory uncertainty.

99. A number of market participants noted that these inquiries are likely to lead to several regulatory changes that will impact the financial services industry participants, but there isn't yet clarity around the scope, cost and timing of these changes. The ACCC considers that the climate of regulatory uncertainty is likely to only inhibit entry (by brokers and aggregators) in the short to medium term, but will likely be resolved in the long term.

Establishment of an adequate pool of brokers including as a result of broker switching constraints

100. The ACCC's preliminary view is that brokers exhibit some degree of 'stickiness' in switching aggregators, due to the costs of switching and other limiting factors on the ability of brokers to switch between aggregators. The ACCC considers that if the combined AFG-Connective's affiliated brokers find it difficult to switch to a competing aggregator, then it may be difficult for new entrants to build an adequate broker portfolio and competing aggregators are unlikely to provide a strong competitive constraint.

101. Market feedback indicates that the following characteristics may limit switching ability:

- provisions in contracts between aggregators and brokers which may limit the ability of brokers to switch to another aggregator or create hurdles to them doing so,
- data transferability issues which might make it difficult for brokers to shift their data from one aggregator's system to another,
- the need for a broker to transfer lender accreditations to the new aggregator's panel of lenders. Some market participants noted this could be a time consuming and expensive process and brokers may have to have agreements with two aggregators in place for a period while it transfers accreditations, and
- the practice of certain aggregators discontinuing the payment of trail commissions on existing loans when a broker leaves them to join another aggregator. However, the ACCC understands that aggregators are moving away from this practice.

102. Broker stickiness as a result of switching costs and constraints appears likely to be a barrier to entry or expansion. New entrants would be unlikely to capture a sufficient number of brokers to make entry worthwhile if brokers are unwilling or unable to move from their current aggregator.

Economies of scale

103. A number of market participants noted that it is necessary to obtain scale (in terms of broker numbers and loan volumes) for entry to be financially viable. They have noted that mortgage aggregation is characterised by high fixed costs, and low margins, making obtaining scale in terms of broker numbers particularly important. A number of lenders noted that the need for scale is one of the reasons why they are reluctant to enter the mortgage aggregation services market.

Network effects and the relationship between the supply of mortgage aggregation services and mortgage distribution services

104. As stated in the ACCC's *Merger Guidelines,* network effects arise when a product becomes more valuable as the number of customers consuming it increases, thus providing an advantage to firms that have an existing customer base over rivals and prospective entrants that do not.[25]

105. Aggregators operate in a two-sided market. Aggregators supply mortgage distribution services to lenders and seek to attract lenders by having a large number of broker customers. Aggregators also supply mortgage distribution services to brokers and seek to attract brokers by having a sufficiently broad and diverse panel of lenders.

[25] ACCC, *Merger Guidelines 2008* (updated 2017), footnote 34 in paragraph 5.42.

106. A large network of brokers may make it easier for an aggregator to attract lenders (i.e. to enter into a contractual relationship with a lender). Some market participants noted that a number of major lenders are reluctant to deal with aggregators that don't generate a sufficient volume of loans. Similarly a large and diverse panel of lenders may attract brokers.[26]

107. Accordingly, network effects may arise from the proposed acquisition, such that the combined AFG-Connective will have a network of brokers so large and attractive to lenders, that it is likely to act as a barrier to aggregator entry or expansion.

The ACCC invites comments from market participants on its preliminary views about barriers to entry and expansion as a mortgage aggregator. In particular market participants may wish to comment on the following:

- What steps are required to enter as a mortgage aggregator? What costs would a new aggregator need to incur and what other factors (in addition to the ones listed above) would a new aggregator need to consider and overcome?
- What steps are required to expand as a mortgage aggregator by increasing the number of affiliated brokers? What costs would an existing aggregator need to incur to expand, and what other factors would an existing aggregator need to consider and overcome? Have there been any recent examples of mortgage aggregators successfully expanding, or failing to expand?
- What steps are required to enter as a mortgage sub-aggregator? What costs would a new sub-aggregator need to incur and what factors would a new sub-aggregator need to consider and overcome?
- What is required for a sub-aggregator to transition into becoming an aggregator in its own right? What costs would it need to incur and what factors would it need to consider and overcome?
- Are there any recent entrant or prospective new entrant mortgage aggregators or sub-aggregators? Please list them.
- What costs would a new entrant mortgage aggregator need to incur to develop its own CRM? How long would this take? How would this differ if it were to lease or licence a CRM developed by a third party?
- How will new regulation affect market participants including brokers and aggregators? How will this new regulation change their duties and compliance costs? What is the anticipated timing of these changes?
- How often do brokers switch between aggregators? Does the likelihood that a broker will switch between aggregators change over the course of a broker's career?
- What steps would a broker need to take to switch from one aggregator to another? How long would such a change take, and what costs would a broker need to incur?

[26] Although market feedback suggests that many brokers do not consider the panel of a lender in the first instance when selecting an aggregator.

Would any of the steps above, or any other steps, take particularly long or be particularly onerous or expensive?

- Are there any aggregators that make it more difficult for a broker to switch? What additional constraints do these aggregators impose on a broker's ability to switch?

Future changes to the mortgage aggregation services market (including digital entrants)

108. As noted in the ACCC's *Merger Guidelines,* when analysing a merger, the ACCC will take into account the changing nature of the market in the future and any dynamic changes to the market that are likely to occur.[27]

109. The ACCC understands that digital entrants are likely to have some impact on financial services industry participants and may impact the way in which these services are provided to the end consumer. This includes recent digital entrants (e.g. Lendi and UNO Home Loans) and the prospective entry of other digital players (e.g. neobanks and fintechs). As noted above in paragraph 51, the ACCC considers that legislative and regulatory changes are also likely to impact the industry.

110. The ACCC has not reached a concluded view on how these digital entrants and other potential changes will impact competition. The ACCC does not currently have sufficient information to suggest that these new entrants or changes to the industry will provide a competitive constraint sufficient to address its competition concerns, and is seeking further feedback on this point.

The ACCC invites comments from market participants on the likely impact on competition of changes to the financial services industry, including digital entrants. In particular market participants may wish to comment on the following:

- What digital trends are likely to impact the financial services industry in the future? How will they impact the role of brokers and aggregators in particular? What is the timeframe in which this impact will take place?

- How has the recent entry of digital players and fintechs (like Lendi and UNO Home Loans) impacted competition in the supply of mortgage aggregation services? In what respect do these market participants provide services that are similar to those provided by traditional mortgage aggregators like AFG and Connective?

ACCC's preliminary views

111. In summary, the ACCC is concerned that that the proposed acquisition is likely to substantially lessen competition in the supply of mortgage aggregation services to brokers.

112. AFG and Connective are the two largest mortgage aggregators, and are close competitors in the supply of mortgage aggregation services. The proposed acquisition will remove the constraint that they currently impose on each other and increase concentration in a market with some significant barriers to entry and expansion.

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[27] ACCC, *Merger Guidelines 2008* (updated 2017), paragraph 7.52.

113. The ACCC is concerned that these factors (amongst the others discussed above) will increase the ability and incentive for the combined AFG-Connective to decrease commissions, increase fees or reduce service levels.

Issue of concern: reduced competition in the supply of mortgage distribution services

114. The ACCC's preliminary view is that the proposed acquisition is likely to substantially lessen competition in the supply of mortgage distribution services to lenders. Combining AFG and Connective will create the largest supplier of mortgage distribution services to lenders in Australia, which the ACCC considers will be likely to raise costs or reduce service levels to its lender customers in the absence of sufficient competitive constraints.

115. The ACCC is primarily concerned with the likely impact of the proposed-acquisition on non-major lenders due to their limited bargaining power and reliance on brokers to compete with major lenders. Market feedback indicates that the major banks offer 'must have' products and may be less likely to face higher costs or lower service levels from the combined AFG-Connective.

The level of concentration in mortgage distribution services

116. The proposed acquisition will create the largest supplier of mortgage distribution services to lenders. As outlined in **Table 1** above, the combined entity will be affiliated with approximately 39 per cent of brokers in Australia. As set out above in paragraph 28, the broker distribution channel is currently the primary channel for most lenders distributing loans, currently accounting for more than half of home loans written. Having access to brokers is critical for many lenders, particularly non-major lenders that rely heavily on brokers. The ACCC understands that for some non-major lenders' brokers account for more than 90 per cent of total loans written per year.[28]

117. The ACCC understands that access to a large number of brokers is the main and most important reason lenders sit on aggregator panels. The type of aggregator (such as franchise) appears to be less important to lenders. Market feedback has indicated that AFG and Connective both have a large number of affiliated brokers and are quite important for lenders to sit on the panel of.

118. The ACCC is concerned due to the importance of accessing AFG and Connective's panel, the combined AFG-Connective will likely be in a strong position to impose higher prices (by negotiating higher commission rates or raising or requiring sponsorship payments) or reduce service for its lender customers, and in particular for non-major lenders who are most heavily reliant on the broker channel.

Lack of alternative aggregators for lenders to access brokers

119. The ACCC understands that lenders tend to sit on a number of aggregator panels. However, market feedback has suggested AFG and Connective account

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[28] Australian Securities and Investments Commission, Report 516: Review of mortgage broker remuneration – March 2017, p. 61.

for a very large proportion of loans largely because of the number of affiliated brokers each have compared to other mortgage aggregators.

120. As shown in **Table 1**, the next largest aggregators include PLAN (1,600 brokers), FAST (1,300 brokers) and Choice (1,300 brokers) for lenders to potentially access other brokers (noting that these three aggregators are owned by NAB, and offer brokers the same CRM). The ACCC is considering the extent to which other large aggregators will provide sufficient access to brokers for lenders.

121. The ACCC understands that for some lenders, there may remain enough alternative panels for them to join or switch to. However, the ACCC is concerned, that for many lenders that heavily rely on brokers, there will not remain sufficient alternative options. In the absence of effective competitive constraints, the ACCC is concerned that the combined AFG-Connective will have the ability to seek higher commissions or sponsorship payments from certain lenders to be on the panel or impose certain conditions to become a panel lender, particularly non-major lenders.

The ACCC invites comments from market participants on its concerns in relation to the issues identified above. In particular market participants may wish to comment on the following:

- How many aggregator panels do lenders generally sit on?
- If you are a lender, are there alternative mortgage aggregator panels to AFG and/or Connective that would provide you with similar access to brokers to distribute your loan products?
- What would be the steps you would take to be placed on the panel of these alternative aggregators?
- Would there be any difficulties to being placed on the panel of these alternative aggregators?
- Would being on the panel of alternative aggregators provide access to a sufficient number of brokers?

Barriers to entry and expansion

122. As discussed in paragraphs 85 to 107, the ACCC considers there are some significant barriers to entry to become a mortgage aggregator and barriers for current mortgage aggregators to expand.

123. The ACCC also does not consider lenders are uniquely or better placed to enter mortgage aggregation and distribution services. An aggregator would still be expected to have a diverse panel and so a lender-owned aggregator would still face all barriers to entry.

The ACCC invites comments from market participants on its concerns in relation to the issues identified above. In particular market participants may wish to comment on the following:

- The extent to which lenders may enter aggregation services themselves in response to an increase in costs or reduction in service levels by aggregators, including the relative costs a lender would face compared to using an aggregation service.

Bargaining power of lenders in negotiations

124. As mentioned in paragraph 40, most lenders tend to set the commission rates paid to mortgage aggregators and there currently appears to be little room for mortgage aggregators to negotiate the rates. However, market feedback has indicated that this dynamic may change post-merger as the combined AFG-Connective will likely be in a stronger position to seek higher commission rates, particularly from non-major lenders that are likely to have lower bargaining power.

125. Market feedback has also indicated that the combined AFG-Connective is likely to be in a position to increase the sponsorship costs for lenders. Based on market inquiries, sponsorship costs may be subject to more discretion and negotiation than commission rates.

The ACCC invites comments from market participants on its concerns in relation to the issues identified above. In particular market participants may wish to comment on the following:

- The relative strength of bargaining power of lenders when setting commission rates paid to aggregators. Including examples of aggregators negotiating higher commission rates with lenders. Also, whether the proposed acquisition is likely to change the strength of any bargaining power and the potential implication on industry practice.

- The relative cost of sponsorship payments to commission rates paid to aggregators.

- How sponsorship costs differ among aggregators, including any examples of aggregators imposing conditions or rates for sponsorship payments.

Ability to bypass the broker distribution channel

126. In assessing whether the ability of customers to bypass a combined entity is likely to act as a competitive constraint on the combined entity, the ACCC considers:

    - Whether the threat to bypass is credible on commercial grounds.
    - Whether the buyer is likely to bypass the supplier.
    - The proportion of the downstream market able to wield a credible bypass.[29]

127. The ACCC does not consider a threat by lenders to bypass the broker distribution channel by relying on and investing in the direct channel is likely to act as a competitive constraint. Brokers are an important means by which loans are sold. The reliance on and demand for brokers from consumers is likely to

[29] ACCC, *Merger Guidelines 2008* (updated 2017), paragraph 7.51.

remain post-acquisition and is likely to limit the extent to which lenders can rely more on the direct channel.

128. The ACCC also does not consider it likely that lenders will bypass the broker distribution channel by dealing with individual brokers directly. This tends to occur on an ad hoc basis that is specific to the individual lender and broker.

The ACCC invites comments from market participants on its concerns in relation to the issues identified above. In particular market participants may wish to comment on the following:

- Whether the direct channel is an alternative to brokers for lenders distributing loans. Including any examples of lenders growing the direct channel in response to aggregators raising costs or denying access to panels.
- Whether the threat to rely less on brokers is likely to constrain the combined AFG-Connective seeking higher commission rates or decreasing service levels.
- The costs for lenders expanding the direct channel, including marketing and other investment expenses.
- The extent to which it is possible for lenders to deal with brokers directly, including costs and any examples of this occurring.

ACCC's preliminary view - the supply of mortgage distribution services to lenders

129. The ACCC's preliminary view is that the proposed acquisition is likely to substantially lessen competition in the supply of mortgage distribution services. The ACCC is concerned that, in the absence of sufficient competitive constraints, the combined AFG-Connective is likely to seek higher commission rates from lenders, to charge higher sponsorship payments to lenders, or to otherwise deteriorate its service offering to lenders (especially non-major lenders).

Issue that may raise concerns: non-major lender foreclosure and reduced competition for the supply of home loans

130. AFG and Connective are vertically integrated, both supplying home loans to consumers through affiliated brokers (including their own-branded products and AFG's securitised products). The ACCC is concerned that combined AFG-Connective will be able to leverage its strong position in the supply of mortgage distribution services into the supply of home loans. In particular the combined AFG-Connective will have an increased ability and incentive to foreclose its rival lender competitors by:

    - restricting access to the combined AFG-Connective's lender panel,
    - raising costs, such as requiring higher commission or sponsorship rates, and/or

- inducing its affiliated brokers to recommend its own branded products over those of rival lenders.

131. The ACCC is particularly concerned about the potential for foreclosure of non-major lenders, which heavily rely on the broker distribution channel to effectively compete in the supply of home loans to consumers. As discussed above, major lenders are unlikely to be adversely affected due to their 'must have' offering, stronger bargaining position and greater reliance on direct distribution channels for their products.

132. The ACCC is considering the effect of potential foreclosure of non-major lenders on the broader supply of home loans to consumers. The ACCC is considering the extent to which non-major lenders offer loans that the major lenders do not (such as lending to borrowers with unique requirements or adverse credit histories). The ACCC is concerned that the foreclosure of non-major lenders may lead to reduced choice for potential borrowers, and reduced constraint for major lenders.

133. The ACCC's preliminary view is that a combined AFG-Connective is likely to have the ability and incentive to foreclose non-major lenders. The ACCC is considering whether the foreclosure of non-major lenders may substantially lessen competition in the supply of home loans to consumers.

Foreclosure in the supply of mortgage distribution services

The potential for lender foreclosure

134. As stated in the ACCC's *Merger Guidelines,* the ACCC is concerned where the merged firm has the ability and incentive to use its position in one market to anti-competitively foreclose rivals in another market in a way that lessens competition.[30]

135. If foreclosed, non-major lenders may not be able to compete as effectively in the supply of home loans against other lenders that sit on the lender panel of the combined AFG-Connective. This may in turn have the effect of substantially lessening competition in the supply of home loans to consumers in Australia.

The ability to foreclose rival non-major lenders

136. The ACCC's preliminary view is that the combined AFG-Connective will have the ability to foreclose non-major lenders due to a lack of constraints for the supply of mortgage distribution services, as considered in the preceding discussion of the supply of mortgage distribution services.

137. An aggregator has the ability to deny access to its panel, and market feedback has indicated some aggregators have denied lender access to the aggregator panels in the past.

138. Market feedback has suggested it is important to brokers that they have access to a panel of sufficient size and diversity to meet their customers' needs. The ACCC is considering the extent to which brokers may leave the combined AFG-

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[30] ACCC, *Merger Guidelines 2008* (updated 2017), paragraph 5.22.

Connective in response to any attempt to limit its lender panel, and whether this would constrain the ability of the combined AFG-Connective to foreclose non-major lenders. The lender panel is only one aspect a broker would consider when choosing an aggregator (such as the CRM as outlined in paragraph 30).

139. The ACCC is also considering the extent to which the combined AFG-Connective is likely to increase the exposure of its products to affiliated brokers at the expense of non-major lenders' products. The ACCC understands that the aggregator software used by brokers recommends loan products to brokers with the potential capability of 'advertising' its own branded products. However, the ACCC is considering the extent to which changes in the regulatory landscape may affect the ability of the combined AFG-Connective promoting its own products through that software.

140. The ACCC's preliminary view is that the combined AFG-Connective will likely have the *ability* to foreclose non-major lenders by denying access, raising costs or inducing brokers to recommend its own branded products.

Increased incentive to foreclose rival non-major lenders

141. As stated in the ACCC's *Merger Guidelines,* a firm is unlikely to exercise its ability to foreclose unless it is profitable to do so, which will depend on the nature of competition in each of the relevant markets and the particular means available to foreclose rivals.[31]

142. The ACCC is concerned that the combined AFG-Connective will have an increased incentive to maximise its own branded sales by engaging in foreclosure strategies against rival non-major lenders. The ACCC is considering the extent to which the combined AFG-Connective would be able to increase profits by selling a greater number of its own products as a result of foreclosing rival lenders. The ACCC is considering the extent to which any such increase in profits by selling more of its own-branded products at the detriment of rival lenders would offset the loss of income from a reduction in the sales of rival loan products.

143. The ACCC understands that some vertically integrated aggregators tend to sell a relatively high proportion of their own branded loans compared to loans from other non-major lenders. The ACCC is considering the possible reasons for this. The ACCC is concerned that the greater margins earned by selling own-branded loans are likely to incentivise the combined AFG-Connective to foreclose rival non-major lenders.

144. The ACCC is concerned that the combined AFG-Connective is likely to have an increased *incentive* to maximise the supply of its products and to prevent non-major lenders having access to the combined AFG-Connective's affiliated brokers.

[31] ACCC, *Merger Guidelines 2008* (updated 2017), paragraph 5.33.

Likely effect of non-major lender foreclosure

145. The ACCC is considering the extent to which this foreclosure of non-major lenders will impact overall competition between lenders in the supply of home loans.

146. The ACCC understands AFG and Connective's own-branded products account for a limited proportion of the overall supply of home loans, and that any incremental increase in the supply of home loans by the combined AFG-Connective resulting from foreclosure is likely to remain limited as an overall proportion of the supply of home loans.

147. However, the ACCC is concerned that if non-major lenders cannot access a sufficient number of brokers they will not be able to effectively compete with and constrain major lenders, potentially magnifying the competitive impact of the foreclosure. The ACCC is considering the role non-major lenders have in the supply of home loans, and how their potential foreclosure could affect competition in the home loan market.

148. The ACCC is also concerned about the impact on potential borrowers if the combined AFG-Connective were to foreclose non-major lenders. If brokers are unable to access to certain lenders, consumers seeking a loan may not benefit from a sufficient amount of lender competition. The ACCC is concerned that the loss of these lenders may harm consumers, particularly those that tend to require non-confirming loans that a major-lender is unlikely to offer.

149. The ACCC is considering whether the foreclosure of rival lenders may substantially lessen competition in the supply of home loans to consumers.

The ACCC invites comments from market participants on its concerns in relation to the issues identified above. In particular market participants may wish to comment on the following:

- Any examples of aggregators refusing access to its panel and any reasons given for the refusal.

- Whether, in practice, the combined AFG-Connective would have the ability to influence loan recommendations to brokers and how this may occur (such as through the CRM platforms).

- Whether the combined AFG-Connective's presence in the supply of home loans would provide an increased incentive to do so. Also whether this practice currently occurs by aggregators.

- Profit margins for aggregators when selling own-branded products compared to other lenders' products, and how these margins may differ for different white-label products such as AFG's product funded by its own securitisation program and products funded by third party lenders.

ACCC's preliminary views - foreclosure

150. The ACCC's preliminary view is that the proposed acquisition may substantially lessen competition in the market for the supply of home loans. The ACCC is concerned that the combined AFG-Connective will have the ability and increased

incentive to foreclose non-major lenders, and that this foreclosure may result in a substantial lessening of competition in the supply of home loans.

ACCC's future steps

151. As noted above, the ACCC now seeks submissions from market participants on each of the issues identified in this Statement of Issues and on any other issue that may be relevant to the ACCC's assessment of this matter. Submissions are to be received by the ACCC no later than 5 March 2020 and should be emailed to mergers@accc.gov.au.

152. The ACCC will finalise its view on this matter after it considers submissions invited by this Statement of Issues.

153. The ACCC intends to publicly announce its final view by 7 May 2020. However the anticipated timeline may change in line with the *Informal Merger Review Process Guidelines*. A Public Competition Assessment for the purpose of explaining the ACCC's final view may be published following the ACCC's public announcement to explain its final view.