Senate Economics Committee

Inquiry into the Consumer Credit Protection Amendment (Fees) Bill 2011

Submission by Mortgage and Finance Association of Australia

10 August 2011

Executive Summary

Schedule 1 of the Consumer Credit Protection Amendment (Fees) Bill, 2011 amends the National Consumer Credit Protection Act 2009 to provide that:
· credit fees or charges relating to credit contracts must be reasonable; and
· the Australian Securities and Investments Commission may apply for a court order to annul or reduce a credit fee or charge it determines not to be reasonable.

Schedule 1 of the Bill is in similar terms as ASIC's Regulatory Guide 220 and accordingly MFAA would support it.

Schedule 2 of the Consumer Credit Protection Amendment (Fees) Bill amends the Banking Act 1959 to require the Australian Prudential Regulation Authority to prohibit banks with a market share of more than 10 per cent from imposing early termination fees in relation to loan agreements or mortgage contracts.

Schedule 2 of the Bill makes sense given the recent history of the exit fee debate, but it only makes competitive sense if accompanied by other regulatory or legislative changes which would also exempt non ADIs from the prohibition on charging early termination fees.

While the thrust of Schedule 2 seems to attempt to facilitate competition in the Australian mortgage market a more positive move would be for the Government to enable the access of the market to more competitively priced funds for mortgage lending.

Mortgage and Finance Association of Australia (MFAA)

MFAA is the peak industry for mortgage and finance brokers, mortgage managers and non-bank lenders in Australia.

Its membership comprises just under 12000, the vast majority of which are mortgage and finance brokers. The remainder comprises mortgage broking groups/aggregators, mortgage managers and non bank lenders, as well as bank and other lenders which distribute their products through the broker channel and industry support services.

Background to Inquiry

During 2010, MFAA worked with ASIC and other organisations providing input to ASIC's review of exit (early termination) fees.

The result of that work was ASICs Regulatory Guide 220 released in November 2010[1] which, in effect, required that exit fees should be reasonable (as defined) and should not exceed the actual cost incurred by the credit provider.

RG 220 made good sense to MFAA and was supported by the industry generally. In particular non-bank and other smaller lenders supported the regulatory guidance because it enabled them to continue to utilise reasonable exit fees ("deferred establishment fees") as a key tool in their competition with the larger banks and providing choice to borrowers.

However, a few weeks after the release of RG 220 the Treasurer announced the Federal Government's Banking Reform package[2], which included a proposed ban on exit fees from 1 July 2011.

In its submission to the Senate Economics Committee Inquiry into Competition within the Australian Banking Sector, in December 2010, MFAA argued[3]:

> *"…we believe ASIC has got the balance pretty right in RG 220 regulating exit fees. This Regulatory Guidance recognises MFAA's long standing argument that Deferred Establishment Fees, transparently disclosed and reasonable in cost, is an important tool to assist non-bank lenders compete and provide choice to consumers.*
>
> *However the solution to the lack of competition does not rest in those areas"*

In March 2011, regulations banning exit fees were signed and published by the Treasurer[4].

The Senate Economics References Committee in its report released on 6 May 2011[5] endorsed MFAA's views with the following Recommendation:

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[1] Regulatory Guide 220: Early Termination Fees for Residential Loans: Unconscionable fees and Unfair Contract Terms.
[2] Competitive and Sustainable Banking; December 2010
[3] MFAA Submission, page 8.
[4] On 23 March 2011, the Government amended the National Consumer Credit Protection Regulations 2010 to prohibit exit fees - National Consumer Credit Protection Amendment Regulations 2011 (No. 2).

Recommendation 4

7.34 The Committee recommends that the Government reconsider its decision to ban exit fees, before the amended regulations come into effect, with a view to allowing enough time for the effectiveness of the existing ban on unfair and unconscionable exit fees (as implemented through ASIC Regulatory Guide 220) to be assessed. If it proceeds with the ban, it should only apply to authorised deposit-taking institutions.

Subsequently MFAA ran a public campaign urging the Senate to implement this Committee Recommendation.

On 23 June 2011, in the Senate, a motion to disallow the regulation banning exit fees was not carried so the regulation came into effect from 1 July 2011.

Following 1 July 2011, some lenders, mainly small or non-bank lenders have increased up front establishment fees applicable to all borrowers to compensate for the loss of their ability to charge deferred establishment fees to the far smaller percentage of borrowers who may wish to switch lenders in the early years of their loans.

Basis of MFAA views

The whole basis of MFAA's support for exit (deferred establishment) fees was not about the ability to charge fees but more about the wider and more important issue of competition in the mortgage lending sector in Australia.

During his appearance in December 2010 before Senate Economics Inquiry into Banking Competition MFAA CEO, Phil Naylor tabled some market share statistics showing the growing dominance of banks in the mortgage market. These statistics are set out in Table 1 following and updated to demonstrate how that dominance has increased in just 6 months.

[5] Senate Economics References Committee: Competition within the Banking Sector, 6 May 2011, page 117

Table 1: Housing Finance Market Share[6]

As at October	Banks %	Bldg Soc Credit U %	Non Banks %
1992	89.8	10.2	
1995	85.7	9.8	4.5
1997	81.6	8.0	9.7
1999	83.2	7.2	10.2
2001	77.6	8.3	14.1
2003	76.9	7.8	15.2
2005	79.5	6.9	13.6
2007	84.8	7.4	7.2
2009	91.4	5.6	3.0
2010	89.2	7.7	3.0
2011 (March)	91.5	7.4	1.2
2011 (April)	92.0	7.0	1.0
2011 (May)	92.5	6.3	1.2
2011(June)	92.3	6.2	1.4

Further ABS refinancing statistics for June 2011[7], also show that refinancing (at 34.9% of all established housing) was at its highest level for some years indicating that while some switching of lenders may be occurring it seems to be really a re-circulation of borrowers amongst the banks, with building societies, credit unions and non-bank lenders not getting a look in. [However refinancing may prove to not be the boon to borrowers that has been promoted. Based on the BankWest/MFAA Home Finance Index[8], 30.9% of those who refinanced in the past 2 years said they did not change credit provider, while only 52.9% said they benefited as a result of the refinance].

The reason for the concentration of finance with banks cannot be attributed to uncompetitive pricing from the smaller operators. The following table shows that in December 2010, the mutuals (viz credit unions and building societies) and non- bank lenders in general had sharper pricing than the major lenders and this increased in June 2011, accepting that competition amongst the larger banks has resulted in widespread discounting of their published rates (estimated by MFAA to be around 50 basis points).

Table 2: Average standard variable rate[9]

	13 Dec 2010	**23 June 2011**
Big 4	7.79%	7.79% (say 7.29%)
Mutuals	7.32%	7.19%
Non bank lenders	7.01%	6.94%

The issue, at least for non-bank lenders represented by MFAA, is access to funds to be able to make an impact with their competitive pricing offer. Although since the demise of securitisation mortgage managers are able to access wholesale funding from banks

6 Source ABS Housing Finance 5609.0: Table prepared by MFAA, Dec 2010; updated June 2011
7 ABS Housing Finance 5609.0, May 2011, Table 1. Note the range over the past decade of the percentage of established dwellings loans subject to refinancing has been 26-34% so the June 2011 percentage is at the top of the range. However it is important to note that the ABS Refinance statistics refer not only to loans switched to another lender but also loans refinanced with the same lender.
8 BankWest MFAA Home Finance Index, May 2011, prepared by *brandmanagement*
9 Source:MFAA calculations based on rate comparisons by Canstar: www.canstar.com.au

probably giving the non-bank/mortgage manager sector around a 5%[10] share of the total mortgage market,(included in the banks market share) if only funds originated by non-bank lenders is taken into account the market share is only 1.2%.

The following commentary from loan ratings organisation Cannex is instructive:

"The impact of the ban on deferred establishment fees, or early exit fees, will be keenly felt by non-bank lenders. In a cruel irony for customers, this move touted by government as increasing home loan competition is likely to result in the exact opposite. Non-bank lenders will have no option but to raise interest rates or, in extreme cases, exit the home lending market altogether. A look at the statistics shows that mortgage originators are suffering. In March2010, CANSTAR CANNEX data showed that non-banks represented 46% of five star home loans. Yet in this current report, dated May 2011,the percentage has whittled down to 12%. The major banks, on the other hand have taken up the slack, going from 12% of five star home loans to 31% in the same period. There's no doubt, non-bank lenders were prosperous before the global financial crisis and really tested the dominance of the major banks in the home loan sector, biting hard into their market share. However, as with most booms, the crunch came and the funding market all but dried up. Capacity to lend became difficult for non-banks and a raft of red tape has now compounded the worries of this sector. For the sake of true competition in the home loan market, we hope the mortgage originators manage to pull some sort of rabbit out of the hat and get into the fray once again."[11]

Table 3 shows the competitive impact the growth on non-bank lenders has had on interest rates by comparing the non- bank lender market share with the difference between the RBA cash rate and the average standard variable rate at each time point in the table. The impact is even more starkly highlighted in the graphs 1 and 2 following which demonstrate a distinct inverse relationship between those two variables.[12]

Table 3 Non Bank Market Share and Difference between Cash Rate and Average Standard Variable Rates[13]

As at October	Average Standard Variable Rate (SVR) %	Cash Rate (CR) %	Difference between CR and SVR % pts	Non Banks Market share %
1992	10.00	5.75	4.25	0
1995	10.50	7.50	3.00	4.5
1997	6.70	5.00	1.70	9.7
1999	6.55	4.75	1.80	10.2
2001	6.30	4.50	1.80	14.1
2003	6.55	4.75	1.80	15.2
2005	7.30	5.50	1.80	13.6
2007	8.05	6.50	1.65	7.2
2009	5.55	3.25	2.30	3.0
2010	7.40	4.50	2.90	3.0
2011 (March)	7.79	4.75	3.04	1.2

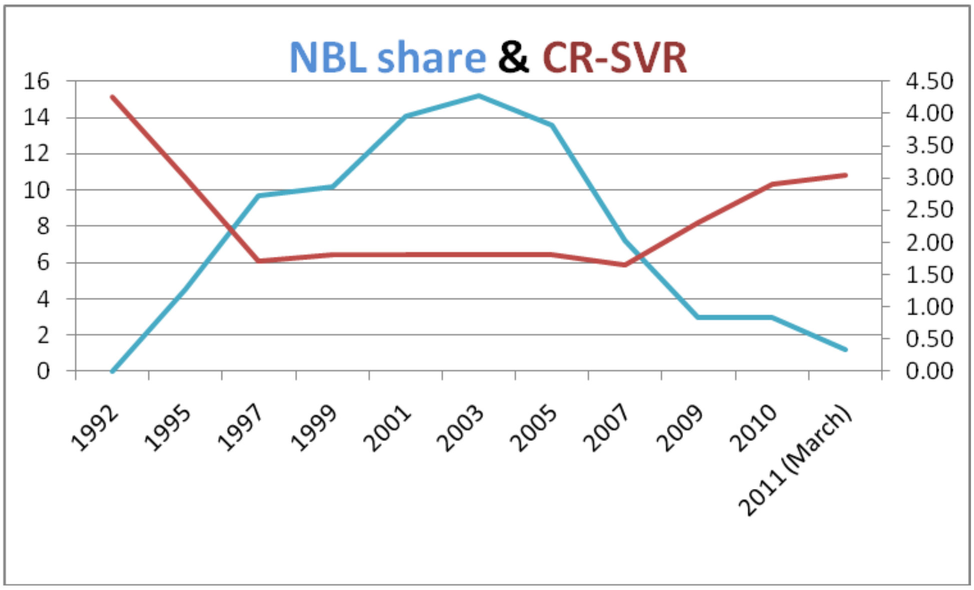
[10] MFAA estimate

[11] Home Loan Star Ratings, Report No 27, May 2011, www.canstar.com.au

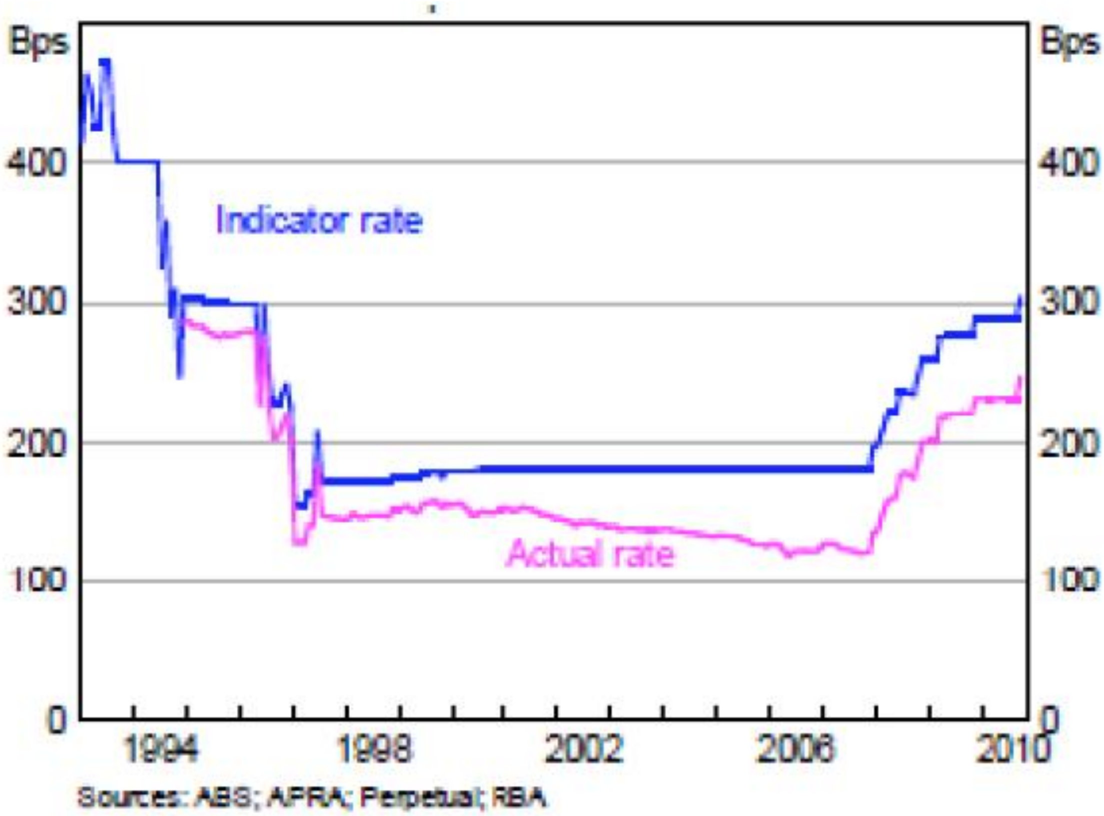
[12] NB Given the SVR discounting in the past decade the actual CR-SVR graph by Mar 2011 would likely be slightly below the line shown at around 2.5 pts –see Graph 2

[13] Source: ABS Housing Finance 5609.0: RBA Statistics: Table prepared by Mortgage and Finance Association of Australia, December 2010, Updated May 2011

Graph 1



Graph 2[14]



MFAA has strongly argued the need for a mechanism in Australia which enables a source of competitively priced funding for non- bank lenders.

[14] Variable lending rates relative to cash rate: Chart 5.7: Senate Economics References Committee: Competition within the Banking Sector, 6 May 2011, part of RBA submission to Inquiry

The Senate Economics References Committee report[15] provides some support (see following) for the Canadian Mortgage Bond program however this seems to be limited and not on an ongoing basis as is the Canadian program.

Recommendation 29

13.78 The Committee recommends that Treasury develop a plan to introduce a support programme for RMBS similar to that operating in Canada in case a future deterioration in the securitisation market requires its introduction.

While the dynamics around exit fees/deferred establishment fees/early termination fees has had some impact on the competitive forces in the Australian mortgage market, a more important factor is the facilitation of competition by ensuring an ongoing source of competitively priced funding.

It is clear that the Government's Australian Office of Financial Management (AOFM) RMBS program initially announced by the Treasurer on 26 September 2008 and subsequently enhanced in October 2009 and April 2011 by AOFM purchasing up to $20 billion RMBS to support competition has had some impact[16], but despite this, non-bank lenders, the traditional major users of this type of funding still languish with around 1% market share, compared to around 7% when the program was announced. However it is noted that that the Direction issued by the Treasurer on 5 April 2011[17] "confirms the temporary nature through the additional objective of encouraging a transition towards a sustainable securitisation market that is not reliant on Government financial support."

Interestingly the 2010 Annual Report of the Canadian Mortgage and Housing Corporation (CMHC) notes that *"CMHC operates its securities guarantee program on a commercial basis at no cost to the Canadian taxpayer"[18].* The Report shows that the National Housing Act mortgage-backed securities (NHA MBS) program and the Mortgage Bond program run by the Canadian Housing Trust produced a combined net income of $C510m in 2010 and $C281m in 2009.[19]

The Consumer Credit Protection Amendment (Fees) Bill 2011

Schedule 1 of the Bill amends the National Consumer Credit Protection Act 2009 to provide that:
· credit fees or charges relating to credit contracts must be reasonable; and
· the Australian Securities and Investments Commission may apply for a court order to annul or reduce a credit fee or charge it determines not to be reasonable.

Schedule 2 of the Bill amends the Banking Act 1959 to require the Australian Prudential Regulation Authority to prohibit banks with a market share of more than 10 per cent

[15] Senate Economics References Committee: Competition within the Banking Sector, 6 May 2011, page 263
[16] The Australian Office of Financial Management's Operational Notice No:2/11 of 8 April 2011 reports that: "To date, the AOFM have assisted 19 lenders in raising over $29 billion in funding. The RMBS issuance supported by the Program has finance mortgages over more than 150,000 residential properties across Australia."
[17] ibid
[18] Canadian Mortgage and Housing Corporation, Annual Report, December, 2010, p51.
[19] Ibid, p53.

from imposing early termination fees in relation to loan agreements or mortgage contracts

Schedule 1 of the Bill in requiring that credit fees of charges must be reasonable viz *must not materially exceed the credit provider's reasonable costs of undertaking the activity or service to which the fee relates* is consistent with ASICs RG 220 and would be supported by MFAA.

Schedule 2 of the Bill is consistent with the secondary point[20] in Recommendation 4 of the Senate Committee Inquiry into Banking Competition in that, in effect, it exempts certain lenders from the prohibition on charging early termination fees. However it only applies to Approved Deposit Taking Institutions (ADIs) regulated by APRA. If passed it would prohibit those ADIs with more than 10% market share from charging an early termination fee, thus enabling those with 10% market share or less to charge such a fee. However it would not provide such relief for those lenders (non-bank lenders) which are not regulated by APRA.

A better and cleaner position is that taken by ASIC's RG 220 which allows such fees provided they are reasonable. The Senate Economics Committee's secondary recommendation to exempt non ADIs also provided for a cleanly defined exemption. The process in the Bill however would impose a prohibition on those ADIs with more than 10% market share, exempt those ADIs with 10% or less market share and leave non ADI's subject to the regulation banning exit fees[21]. Such a result would be unhelpful to non ADIs, the very lenders who were most negatively impacted on by the exit fee ban.

A result which exempted the <10% ADIs and non- bank lenders would make more sense given the arguments around the impact of exit fees on competitive forces in the mortgage market.

As Schedule 2 does not bring about such a result, MFAA would not support this amendment unless it was accompanied by a similar regulation or legislation which exempted non–ADIs.

Conclusion

Schedule I of the Bill is in similar terms as ASIC's RG 220 and accordingly MFAA would support it.

Schedule 2 of the Bill makes sense given the recent history of the exit fee debate, but it only makes competitive sense if accompanied by other regulatory or legislative changes which would also exempt non ADIs from the prohibition on charging early termination fees.

While the thrust of Schedule 2 seems to attempt to facilitate competition in the Australian mortgage market a more positive move would be for the Government to enable the access of the market to more competitively priced funds for mortgage lending.

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[20]"If it proceeds with the ban, it should only apply to authorised deposit-taking institutions". Senate Economics References Committee: Competition within the Banking Sector, 6 May 2011, page 117

[21] National Consumer Credit Protection Amendment Regulations 2011 (No. 2)