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The Secretary
Senate Standing Committee on Economics
PO Box 6100
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CANBERRA ACT 2600

Consumer Credit Protection Amendment (Fees) Bill 2011

The Australian Bankers' Association appreciates the opportunity to provide comments to the Committee on the *Consumer Credit Protection Amendment (Fees) Bill 2011* ('Bill').

The ABA is the peak national body representing 23 banks authorised by the Australian Prudential Regulatory Authority (APRA) to carry on the business of banking in Australia. The ABA's membership includes the four large banks, foreign banks and smaller retail banks, all of which operate on a national scale.

1. Introductory Comments

1.1 Schedule 2: Early Termination Fees

The Bill, if passed, will result in a ban on large authorised deposit taking institutions (ADIs) (with a market share greater than 10%) charging early termination fees on any loan agreement or mortgage contract while permitting smaller ADIs and non-ADI lenders to charge those fees.

The ABA submits that a similar market distortion as has occurred with the Government's ban on mortgage exit fees is likely to occur if the Bill is passed. On 1 July 2011 a Government ban on consumer credit providers charging mortgage exit fees on variable interest rate mortgage loans came into force.

The Mortgage Finance Association of Australia (MFAA) has submitted to this inquiry that in the period before the Government ban commenced banks removed certain exit fees which resulted in a situation described in The Age newspaper on 15 August 2011 in this way:

> *"Small home lenders cannot compete with the big players, as the exit fee ban has hurt their business model, the association (MFAA) says."*

Some small and non-bank lenders increased up front establishment fees applicable to all borrowers, as a result of not being able to charge deferred establishment fees (exit fees) to a smaller percentage of borrowers who terminated their contract early, a risk that was emphasized by industry to the Government during consultation.

The result was stated by the MFAA and reported as:

> *"While some switching of lenders may be occurring it seems to be really a recirculation of borrowers amongst the banks, with building societies, credit unions and non-bank lenders not getting a look in."*

If, as a result of this Bill, all lenders with a market share of deposits less than 10% are permitted to charge mortgage exit fees, consumers are more likely to choose a lender that does not charge mortgage exit fees (large ADIs) than one that does. This may result in a further concentration of the mortgage market.

Further, because the Bill would amend the Banking Act 1959, the Bill would apply to all credit contracts (secured or unsecured), not simply to consumer credit contracts. The Bill would therefore result in a large lender being prohibited from charging an exit fee under any credit contract - commercial, corporate or consumer. It is the ABA's understanding that such an intervention into freedom of contract would be unprecedented.

Further issues related to the proposed treatment of early termination fees in the Bill are detailed in section 4 of this submission.

1.2 Schedule 1: Credit fees or charges – Duplication of existing law

The ABA submits that the Bill would largely duplicate recently enacted law and add another layer to the regulation of credit fees and charges thereby creating uncertainty and potentially conflicting interpretations.

Schedule 1 of the Bill proposes that "a credit fee or charge payable by a debtor to a credit provider must be reasonable" and that in determining whether a credit fee or charge is not reasonable ASIC may have regard to whether the amount of the credit fee or charge "materially exceeds the credit provider's reasonable costs".

The market and economic consequences of the proposed regulation of credit fees and charges, by linking it to cost recovery, do not appear to have been considered. If credit providers are confined to charge fees on a cost recovery basis only, this would signal that income should be generated by interest rates only.

The implication that credit providers should only make money from interest is completely inappropriate, particularly in the cards space where a significant proportion of customers do not revolve balances. By regulating the fees and

charges that can be imposed issuers will inevitably increase interest rates and this will affect those that can least afford to pay higher interest. In other words, those customers that do not pay off their balances each month would be subject to higher interest to subsidise all others, and the credit provider would not be able to earn any money from customers that pay their balances off.

Currently, there is competition in the consumer lending market in terms of both the cost of loans and choice of credit providers. The consequences cited above in relation to smaller lenders and early termination fees are likely to be relevant for credit fees and charges should the Bill be passed, namely a concentration of the market to larger lenders.

2. Background to the early termination fees debate

During 2010, the ABA was consulted by ASIC during their review of early termination fees (exit fees). ASIC released Regulatory Guide 220: *Early termination fees for residential loans: unconscionable fees and unfair contract terms* in November 2010. RG220 provided guidance on how the provisions of two national laws administered by ASIC applied to exit fees for residential loans, namely:

1. The National Credit Code, which is part of the *National Consumer Credit Protection Act 2009* (NCCP), particularly the unconscionable fees provisions in section 78 - 79; and

2. The *Australian Securities and Investments Commission Act 2001* (ASIC Act), particularly the unfair contract terms provisions in subdivision BA of Division 2 Part 2.

RG220 sets out ASIC's guidance on when an early termination fee may be unconscionable or unfair and requires that a fee payable on early termination should reflect a reasonable estimate of the lender's loss arising from the early termination of a loan and should not exceed the actual cost incurred by the credit provider. Accordingly, RG220 set out:

- the costs and types of loss that could be included in exit fees;
- the types of loss that should not be recovered through exit fees; and
- the limited circumstances in which a lender could vary exit fees during the life of a mortgage.

The law was found by ASIC to limit exit fees to the recovery of a lender's loss caused by the early termination and could not be used to discourage a borrower from switching their loan or 'punishing' a customer for doing so.

Both the National Credit Code and unfair contract term provisions commenced on 1 July 2010 and allow borrowers to challenge the validity of exit fees they think are unconscionable or unfair. The borrower or ASIC can seek court review of these fees.

Under the National Credit Code, a court can annul or reduce an exit or pre-payment fee if the court determines it exceeds a reasonable estimate of the lender's loss arising from early termination or prepayment i.e. the fees are found to be unconscionable under the NCCP. Alternatively, under unfair contract terms legislation a court can declare terms void if the court finds the terms are unfair and may make orders directed at redressing the loss suffered by consumers as a result of unfair terms.

Despite the release of ASIC RG220 and the availability of remedies for consumers under the National Credit Code and unfair contract term provisions, the Treasurer announced the *Competitive and Sustainable Banking Reform Package* in December 2010. This package included a proposal to ban the charging of exit fees on certain consumer credit facilities from 1 July 2011 via regulation-making powers of the NCCP.

In its submission to Treasury in February 2011 on the *National Consumer Credit Protection Amendment Regulations 2011*, the ABA noted that none of the statutory provisions under the National Credit Code, the ASIC Act nor the Australian Consumer Law 2010 contemplate an absolute prohibition of home loan exit fees because the provisions are based on principles of justification for charging the particular fee. Conversely, the Government's policy approach was a form of price control that amounted to an absolute prohibition of home loan exit fees irrespective of their justification. This policy approach was adopted by the Government despite Treasury and ASIC recognizing that a cost may be incurred by a credit provider due to an early termination of a consumer credit contract. Despite industry objections the regulations banning exit fees were signed and published by the Treasurer on 23 March 2011.

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

3. Consumer Credit Protection Amendment (Fees) Bill 2011

3.1 Schedule 1

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.

3.2 Comments

Schedule 1 of the Bill utilises similar terminology to ASIC's RG 220 but has a broader application than existing law. For example,

- ASIC's RG 220 applies to early termination fees (exit fees), defined as "any fee payable on early termination of a residential loan, generally including deferred establishment fees".
- Section 78 of the National Credit Code covers changes in annual percentage rates, establishment fees or charges, early termination fees or charges and prepayments fees or charges.
- The unfair contract terms provisions of the ASIC Act apply to standard form consumer contracts that are financial products or contracts for the supply or possible supply, of financial services. However, the upfront price payable under the contract is excluded from fairness considerations[1].

Conversely, the Bill applies to any and all credit fees and charges. The Bill also exceeds the Government's ban on mortgage exit fees[2], which applies only to variable interest rate home loans as break fees and discharge fees are excluded.

The Bill, written in technically different language from the current law, would therefore add a third layer of regulation on top of what is currently contained in the National Credit Code and unfair contract terms legislation and would extend the unfair contract terms legislation as it requires that fees are 'reasonable' and do not 'materially exceed' the lender's average costs.

As noted above, the Bill links the concept of a "reasonable fee or charge" to cost recovery. However, in practice there is a lack of connectivity between these two concepts. There are many valid instances where a fee is more than cost recovery but may still be reasonable and not excessive. For example, the application of the Bill to "all credit fees and charges" would be particularly problematic for credit cards that carry an annual fee as annual fees appear to be captured under the definition of fees and charges. Some lenders may charge annual fees for their highest tier of credit card that range above $500. However, the card will most likely offer benefits and other reward points options that lower tier cards at a lower annual rate do not. A consumer is always entirely free to choose a different product with a different and lower annual fee. The annual fee is not currently tied to the exact cost to the lender of providing those benefits. The Bill and the proposed linkage between all credit fees or charges and costs to the credit provider could therefore destroy innovation in the cards market.

The fact that a fee or charge may be more than cost recovery but still reasonable and not excessive is implicitly recognised in the existing law of the NCCP and Australian Consumer Law. Therefore the proposed Bill would introduce a significantly new concept and conflict with existing law. The ABA strongly argues that there is no need for any further legislation for credit products, particularly not for credit fees or charges.

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[1] The upfront price does not include any fees/charges that are contingent on the occurrence or non-occurrence of a particular event, for example, default on a loan.

[2] Defined as fees paid on or in relation to the termination of the credit contract where credit secured in whole or part by residential property.

4. Schedule 2

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

Like Schedule 1, Schedule 2 is broader than the recently introduced NCCP regulation which prohibits mortgage exit fees outright. As noted above, the ban applies to fees paid on, or in relation to, the termination of the credit contract where credit is secured in whole or part by residential property i.e. ban on mortgage exit fees. However, the regulation excludes break fees (which apply to fixed rate loans) and discharge fees (which reimburse the credit provider for the reasonable administrative cost for terminating the credit contract).

In contrast, the Bill applies to any early termination fee in respect of any loan agreement or mortgage contract.

Because the Bill does not exclude break fees, a bank would be unable to charge an early repayment adjustment and administrative fee on fixed rate loans that were repaid within the fixed rate term. Consequently, banks would bear the risk of borrowers choosing to repay their fixed rate loans early if interest rates dropped, banks would be forced to either increase the interest rates charged on fixed rate loans or cease offering fixed rate loans. The Bill would therefore have extensive detrimental effects, particularly on the availability of fixed rate loans to Australian consumers.

The Bill also does not exclude discharge (settlement) fees. Whether a bank could charge the discharge fee on all repaid loans (fixed and variable rate) would depend on whether the fee would be charged by the lender when the consumer repays the loan at the end of the loan term as the draft legislation bans any "additional" fee.

As the Bill applies to all loans a bank would not be able to charge a listed company an exit fee on a corporate loan.

The ABA also notes that no transitional period is provided for the introduction of the reforms. It is not practical to expect credit provider's to immediately comply with the reforms and for APRA to vary all section 9 authorities under the *Banking Act 1959.*

4.1 Small lenders

We note that part of the policy intent of the Bill is to enable smaller lenders to impose mortgage exit fees, but retain the exit fee ban for larger banks including

the four major Australian Banks: CBA, WBC, ANZ and NAB[3]. The Bill intends to achieve this by reversing the Government's blanket ban on exit fees for lenders with a market share of less than 10%, due to the purported detrimental impact of the ban on smaller lenders. The Bill would therefore reinstate the ability of smaller lenders to charge reasonable mortgage exit fees to recoup some of their legitimate costs associated with early termination, so long as they are not unconscionable or unfair in line with current legislation.

However, the only way to achieve the purpose of the Bill would be for the existing regulation banning exit fees under the NCCP to be repealed. Without repealing the regulation, smaller lenders will remain unable to charge exit fees due to the existence of the blanket prohibition.

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[3] We also note that as a result of the current drafting the 10% market share threshold would include foreign banks such as HSBC and CitiBank as the definition is not limited to Australian deposit liabilities. It is not clear whether the capture of foreign banks was intentional.

5. Recommendation

The Bill before the Committee largely covers areas of credit law that have been the subject of extensive new regulation in the past year or so. It is unclear what additional issues the Bill is seeking to address or why it is perceived that there are gaps in the current legislation. The Bill also seems to have a range of unintended consequences, including regulating the credit arrangements between banks and large corporate customers and negating the contract that underpins the concept of fixed interest loans. Given the Government's blanket ban on mortgage exit fees, it seems unlikely that the Bill can give any relief to those smaller lenders that have been disproportionately affected by the ban.

On these grounds, the ABA believes that the Bill is unnecessary and should not proceed. We would be happy to address any further questions that Committee may have.

Yours sincerely

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