Senate Standing Committee on Economics

ANSWERS TO QUESTIONS ON NOTICE

Treasury Portfolio

Budget Estimates

1 June – 3 June 2010

Question: BET 33

Topic: **Exit & Establishment Fees on Loans**

Hansard Page: E130-131 (01/06/2010)

Senator WILLIAMS asked:

Senator WILLIAMS—I think I have used this analogy before: if you take your car to the garage and are not happy with the job, you get home and the sump plug is not done up properly so it is dripping oil et cetera, you can then just take your car down the road to another garage, you do not have to take it back and there is no contract. With exit fees on variable loans—and I specify variable loans as I understand that on fixed loans you have a contract and you have to meet your deal; if you want to get out early on a fixed loan you have to pay the difference—but on variable loans shouldn't it be the case that there should be a legislated ban on exit fees to bring proper competition into the finance industry? As well as banning establishment fees, let the banks and financial institutions put the establishment costs onto the interest rate on a margin so you have proper competition where you can just walk out of one institution, go into the next institution and all you have to pay is the stamp duty on your mortgage, and then you would have real competition. While you have an exit fee the bank might have a monthly charge of $10 on your account. They could put it up to $12 a month and you would say, 'That's not very nice; I'm not happy,' but you are not going to pull out of it, because you would have to pay the $1,000 or $2,000 exit fee. So they actually have you hand-cuffed to their product and you cannot get out. For proper competition in finance, shouldn't we be looking at banning exit fees and establishment fees on variable loans?

Mr D'Aloisio—It is a policy matter for government, Senator.

Senator WILLIAMS—Perhaps the minister might address it.

Mr D'Aloisio—Obviously, ASIC has looked at account switching. We have clearly come up with the industry enabling people to switch accounts so that their periodic payments transfer across if they go to another bank. We have been working with industry on the exit fees on mortgages to make it easier for consumer rights to be determined. We will now work with the unfair terms legislation to do that. Ultimately, the broader policy issue that you are referring to is a government policy issue.

Senator WILLIAMS—Minister, would you like to comment on it?

Senator Sherry—Well, the chair is right. Prohibition or regulation, and the extent to which you do that on particular types of fees and practices, is a policy matter for government. In a perfect well-informed competitive market, conceptually, an informed individual—and obviously that is a heavy caveat; it is not a criticism—would have an unfettered choice or right of selection. In other words, they would have the ability to move from one product to another, maximising competitive pressure. That is the theory.

Senator WILLIAMS—The theory, yes.

Senator Sherry—That is the theory but obviously in some areas of financial services the practice in reality can be quite different.

Senator WILLIAMS—Exactly.

Senator Sherry—There are a number of inhibiting factors to that theory of perfect competition. One is a knowledge base to make an informed choice. Another is conflicts of interest in the advice that may be given— whether that is direct ownership or a reward which represents a conflict. I think you point to a legitimate barrier to competition in some circumstances.

Senator WILLIAMS—Of course it is.

Senator Sherry—An exit fee can clearly represent a barrier to moving from one product to another, if a consumer wishes to do that, in some circumstances.

Senator WILLIAMS—I would say that it would be a barrier in many circumstances because many— probably hundreds of thousands—people in Australia have variable loans on their homes. When we had an interest rate rise—I think it was in December—my rate went up 0.44 per cent but it would have cost me $1,000 to exit my loan. I was not happy with my bank when they did that and I told them: next time you move it up past the Reserve Bank rate of 0.25 then I will gladly pay the $1,000 to go down the road. But the cost of getting out of a loan—because of monthly charges—makes a mockery of that ability. Also, when we see the banks cribbing up above the Reserve Bank price, Treasurer Wayne Swan said, 'Go down the road; use your competition.' You cannot use competition when you have to pay to get out of the loan you are in, by way of an exit fee.

Senator Sherry—I have already accepted and acknowledged that in some circumstances it can be an inhibition or a restriction on the operation of effective competition. There are some circumstances where that does occur—I am making an observation—however, the extent to which that requires any direct policy intervention, regulatory oversight, is a matter for my colleague Chris Bowen and broader government. It is a matter of policy and I would have to take on notice whether or not the government would intend to act in any area, as you would suggest.

Mr D'Aloisio—If it assists you, we produced a report for the Treasurer in April 2008—which I think is on our website or I can make it available to you—where we did an industry review of the mortgage entry and exit fees, to give a bit of a feel for what was going on in the industry, as a bit of benchmark. We will use that and go back and do further reports to see how issue develops with new laws and so on.

Senator WILLIAMS—That would be good if you did because—

Senator Sherry—There is another issue or another factor in all this, and that is what is called inertia—the actual time and focus that an individual gives once they are in a particular product provided by a particular provider. Do you need an opt-in or an opt-out approach?

Senator WILLIAMS—You can do it at a credit union. It did not cost me anything to walk out of the credit union to change.

Senator SHERRY—But there are a certain proportion of people that remain locked in because of the inertia of not making a decision. There is some interesting work there.

Senator WILLIAMS—I am a big believer in free enterprise and competition. I think it inhibits competition in the finance industry, and the finance industry should be no different to the ordinary retail shop down the street, in my opinion.

Senator Sherry—I accept that there is an argument in some areas, but the level of direct regulatory intervention is a policy matter for government which I have to take on notice.

Answer:

Under the National Consumer Credit Code which commenced on 1 July 2010, a consumer, or ASIC may seek court review of an early termination fee under a mortgage contract on the basis that it is unconscionable. A key determinant of 'unconscionability' will be whether the fee reasonably equates to the lenders loss arising from the early termination. The Code provisions apply to new and pre-existing mortgages.

Since 1 July 2010, ASIC has also had jurisdiction to examine new mortgage contracts for any "unfair terms". A term is "unfair" when it causes a significant imbalance in the parties' rights and obligations arising under the contract and is not reasonably necessary to protect the legitimate interests of the party that would be advantaged by the term. The Unfair Contract Terms provisions will only apply to new mortgages.

Early termination fees and break fees will generally be subject to the new unfair contract terms provisions because they are contingent fees.
ASIC has consulted with industry in order to produce a Regulatory Guide on mortgage exit fees and unfair contract terms. Our guidance will also cover the provisions in the National Credit Code which prohibit ‘unconscionable’ early termination fees on mortgages. A Consultation Paper was issued on 27 June 2010 and the consultation period closed on 9 August 2010. We are currently considering stakeholder submissions and will look to publish regulatory guidance before the end of 2010.

ENDS