25 February 2011

By email: banking@treasury.gov.au

John Lonsdale
General Manager
Financial System Division
The Treasury
Langton Crescent
PARKES ACT 2600

Dear Mr Lonsdale

Exposure Draft - National Consumer Credit Protection Amendment Regulations 2011

The Consumer Action Law Centre (**Consumer Action**) welcomes the opportunity to comment on the exposure draft of the National Consumer Credit Protection Amendment Regulations 2011 (the **Regulations**), setting out the proposed amendment to ban exit fees on new home loans.

We support the amendments in principle and broadly in the terms of the proposed Regulations. However, we recommend that changes be made to tighten the definition of “break fee” and that, while the intention is sound, the exemption for "discharge fees" be removed. Our comments are detailed more fully below.

About Consumer Action

Consumer Action is an independent, not-for-profit, campaign-focused casework and policy organisation. Consumer Action provides free legal advice and representation to vulnerable and disadvantaged consumers across Victoria, and is the largest specialist consumer legal practice in Australia. Consumer Action is also a nationally-recognised and influential policy and research body, pursuing a law reform agenda across a range of important consumer issues at a governmental level, in the media, and in the community directly.

Since September 2009 we have also operated a new service, MoneyHelp, a not-for-profit financial counselling service funded by the Victorian Government to provide free, confidential and independent financial advice to Victorians with changed financial circumstances due to job loss or reduction in working hours, or experiencing mortgage or rental stress as a result of the current economic climate.

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Prohibition of home loan early exit fees

As we said in our evidence to the hearing of the Senate Economics Committee's inquiry into competition within the Australian banking sector conducted on 25 January 2011[1], we support the Government's move to ban home loan early exit fees. We are of the firm view that such a ban will allow the home loan market to operate more effectively and competitively.

As you are aware, advice provided by the Treasury (subsequently released through a Freedom of Information request) contained discussion about the possible effects of such a ban. Some aspects of the advice, which have been reported in recent days by the media, relate to concerns that we addressed in our evidence to the Senate inquiry. We would like to take this opportunity to set out our views on some of these concerns about a ban on mortgage early exit fees and reiterate our support for this regulatory measure.

Cost-shifting

One of the concerns that has been expressed is that a ban would force lenders to recover costs in other ways, such as by raising their interest rates or increasing other fees.

To the extent that early exit fees do represent genuine costs to the lender, there is no argument that lenders may move to recover these costs in their upfront fees or interest rates. However, that is essentially the main point of this reform. Far from being a problem, this cost shifting will actually benefit consumers and competition.

To drive effective competition, we need consumers to be able to make accurate assessments of the overall price or cost of the home loans they are considering and make an informed choice of home loan based on this information. The headline interest rate represents only one component of the total cost of the home loan, with up-front fees, monthly or annual account fees and exit fees also forming part of the total price of the product.

By back-ending some fees and expressing them to be contingent on an event occurring or not occurring, consumers are much less likely to be aware of them than if they were disclosed clearly upfront. Behavioural insights also teach us that consumers are less able to take these sorts of fees into account in calculating the total cost of the loan than an upfront fee, due to biases such as overconfidence and hyperbolic discounting. This may lead consumers wrongly to choose a loan that is actually more expensive in total.

The proposed Regulations may mean that lenders shift costs from early exit fees to interest rates or front-end fees. In doing so, lenders will be removing fees that are back-ended and expressed as contingent, and replacing them with fees or rates that are much more visible. This will mean it is much more likely that consumers will be better informed about the true price of different loans, allowing them to more easily choose which is best for them. In turn, making these prices more visible will make them more sensitive to competition, as consumers shopping around will take them into account, driving down the overall price of home loans to more efficient levels in the long term.

[1] The transcript can be viewed at http://www.aph.gov.au/Senate/committee/economics_ctte/banking_comp_2010/hearings/index.htm.

Arguably, at present deferred establishment fees (another name for early exit fees) are often charged for a certain period (say, five years), on the argument that the lender will recover those establishment costs during that period through other fees, charges and interest. In this case customers will currently be paying higher than efficient interest rates after the fifth year, given that their interest rates are set to recover establishment costs which have already been recovered.

Although the released Treasury advice appears to agree that customers may give more attention to upfront fees, and thereby increase competitive pressure on those fees, it also states:

> those same customers may be worse off as the fees they are more easily able to compare will be unavoidable, unlike exit fees.

This statement appears to suggest that it is better for consumers to stay with an uncompetitive loan (and avoid an inflated early exit fee) than to switch to a competitor who is offering a better deal. This is a poor outcome for consumers, who are discouraged from getting the best deal available. It is equally bad for competition, as it denies revenue to lenders who invest in creating a better product and rewards those with an inferior product but high exit fees, creating little incentive to lenders to compete by offering the better product.

Subsidisation

Another concern that has been expressed is that banning early exit fees would, as described in the Treasury advice, "force customers that rarely switch institutions to cross-subsidise those that do regularly".

There are a number of flaws with this argument. The first is that an exit fee ban still permits lenders to bill customers for genuine costs associated with establishing a home loan. To the extent that the set-up costs of home loans are currently being charged as exit fees, it could perhaps be said that customers who switch loans and pay an early exit fee are subsidising those customers who do not switch.

Secondly, this concern is simply a variation of the one discussed above under 'Cost Shifting'. The subsidisation argument assumes that it is better to have consumers continue paying for an uncompetitive product than it is for them to take their money elsewhere. On the contrary, customer switching is not a burden on the home loan market but an essential activity if we are to have an effectively competitive market. The argument essentially admits that exit fees do have the anti-competitive effect of locking customers into uncompetitive products.

Finally, this argument tends to imply that borrowers who exit their home loans early are a fickle minority, and their more loyal compatriots would be subsidising their switching were it not for early exit fees. As noted above, however, it is actually desirable to have a significant number of borrowers shopping around and switching home loans to drive competitive outcomes in the market. Further, in ASIC's *Review of Mortgage Entry and Exit Fees*, it is noted that 2006 research by Fujitsu Consulting and JPMorgan found that "the average Australian mortgage is

terminated or refinanced within approximately three years".[2] The ASIC report went on to say that early termination fees were "typically charged for mortgages that are terminated in the first five years (though in some cases beyond this period)".

On these figures, the average (not the exceptional) customer can expect to pay an early exit fee. To the extent that these fees represent genuine costs, this might mean that their lender's overall interest rates are lower and it might then be argued that the average home loan customer is currently cross-subsidising interest rates for the minority of borrowers who avoid switching.

Effect on smaller lenders

Finally, the Treasury advice also notes concerns that banning exit fees may harm the ability of smaller lenders to compete, as smaller lenders typically charge greater exit fees to offset discounts elsewhere in the loans.

We agree that some lenders do use higher exit fees to offset front-end and ongoing costs to attract customers from other lenders. However, we do not agree that this necessarily represents effective or beneficial competition.

By offering a lower interest rate and offsetting those costs with a higher exit fee, a lender is simply making their product *appear* cheaper by obscuring some of the costs. Competition from smaller lenders is beneficial, but merely making a product appear better is not genuine competition, in the same way that attracting customers away from other suppliers in a market by using, for example, misleading or deceptive advertising or predatory pricing, would not represent effective competition.

The draft regulations

Consumer Action supports the proposed Regulations, including the break fee exclusion. In our view, the proposed amendment is generally well targeted. For example, we support the proposed definition of a "credit contract for a home loan" under draft regulation 79A(2), as it ensures that all loans relating to residential property are covered, regardless of whether the loan application expresses that the property purchase and/or loan are for owner-occupier or investment purposes.

However, we recommend that the break fee exception should be tightened and the discharge fee exception be removed, for the reasons set out below.

Break fees exception

The break fees exception is defined in the following terms:

> (3) In this regulation:
>
> ***break fee*** means a fee or charge that:

[2] ASIC's report is available at http://www.asic.gov.au/asic/pdflib.nsf/lookupbyfilename/rep_125_review_of_mortgage_entry_and_exit_fees.pdf/$file/rep_125_review_of_mortgage_entry_and_exit_fees.pdf

(a) relates only to the early termination of a credit contract for a fixed loan; and
(b) is payable as a result of a change in the cost of funds to the credit provider.

...

fixed loan means a credit contract under which, at the time of early termination of the credit contract, the annual percentage rate is fixed for the whole or part of the amount due under the credit contract.

While the exception correctly defines a fixed loan to include part fixed and part variable loans, the definition of the fee does not then limit the break fee to a fee payable with regard to the fixed element of a part fixed loan only. As a result, where a loan is part fixed and part variable, the regulation could be read as allowing break fees to be calculated with regard to the total amount due under the contract rather than only the amount subject to a fixed annual percentage rate.

We acknowledge that the break fee definition attempts to prevent this problem by stating that a break fee is a fee payable 'as a result of a change in the cost of funds to the credit provider'. However, we do not believe that this ensures that a break fee can only be charged with regard to the fixed part of the amount due under the credit contract.

We suggest that the regulation be amended so that the definition of a break fee also refers to the fee relating only to the amount due under a credit contract for a fixed loan for which the annual percentage rate is fixed (where the loan is part fixed and part variable). Although this is clearly the intention of the proposed regulation, we feel that adding this detail is necessary to remove a possible loophole.

Discharge fees exception

While we agree with the intent of the discharge fee exception, we believe it provides a loophole which will allow lenders to continue effectively charging early exit fees. On the other hand, removing the exception will not cause any harm, as lenders will be able to recover discharge costs through establishment or ongoing fees. For this reason, we recommend the exception be removed.

The discharge fee exception is defined in the following terms:

(3) In this regulation:

...

discharge fee means a fee or charge that only reimburses the credit provider for the reasonable administrative cost of terminating the credit contract.

...

(4) For the definition of ***discharge fee***, a cost is a reasonable administrative cost only if it does not exceed a reasonable estimate of the average reasonable administrative cost to the credit provider of terminating that class of credit contract.

We accept that there are genuine administrative costs involved in terminating a credit contract. However, we understand that the intention of this exemption is to allow only those genuine

administrative costs associated with termination at any point in time, not the costs associated with an *early* termination specifically, otherwise it would be enabling early exit fees. In its current form, we believe the proposed regulation could allow lenders to charge for early termination.

For example, lenders could offer to waive a loan discharge fee after a certain time, making early exit more expensive than later exit. Although in this scenario the fee charged for an early exit would still need to be reasonable in itself, the offer to waive the fee at a later point would still act to discourage exit in the same way early exit fees do now.

Allowing an exemption for discharge fees provides a method for avoidance of the exit fee ban. The example given above in one possible means of avoidance, and another would be for a lender to inflate the fee above its administrative costs but not obviously so. Neither consumers nor even the regulator, ASIC, are in a position to assess whether a particular discharge fee imposed by a lender is set at a level that is reimbursing the lender for more than their reasonable administrative costs, without significant and costly investigation.

We also make the point that if the cost of discharging the credit contract is the administrative cost associated with ending the contract whatever the time of discharge, and it is being determined upfront, this cost could just as easily be incorporated by a lender into an upfront fee.

For these reasons, we do not think an exemption for discharge fees is necessary. As it is not necessary and opens up an avenue for avoidance, we recommend it be removed from the Regulations.

At the very least, we suggest that this definition could be improved by specifying that a discharge fee is one that reimburses the credit provider for the average reasonable administrative cost of terminating the contract at any point during the loan term (not also the cost, if any, of exiting a contract early), and that a fee or charge is not a discharge fee if it is greater than the fee which the customer would pay if they terminated the contract at a later date.

Thank you again for the opportunity to comment on the proposed amendment. Please contact us on 03 9670 5088 or at david@consumeraction.org.au if you have any questions about this submission.

Yours sincerely
CONSUMER ACTION LAW CENTRE

Nicole Rich
Director, Policy and Campaigns

David Leermakers
Policy Officer

Broadfoot v RHG Mortgage Corporation Limited (Commercial) [2009] NSWCTTT 447 (14 August 2009)

CONSUMER, TRADER AND TENANCY TRIBUNAL
Commercial Division

APPLICATION:	COM 08/36755
APPLICANTS:	Andrew Broadfoot & Kristen Broadfoot
RESPONDENT:	RHG Mortgage Corporation Limited
APPEARANCES:	Mr Batley of Counsel instructed by Ms Alexandra Kelly, Solicitor, Consumer Credit Legal Centre for the applicants Mr Newton of Counsel instructed by Ms Angelina Care for the respondents
HEARING:	6 April 2009 at Penrith
LEGISLATION:	*Consumer Credit Code (New South Wales)*
CASES CITED:	*Dunlop Pneumatic Tyre Co Ltd [1915] AC 79* *Australian Finance Direct Ltd v Director of Consumer Affairs Victoria [2004] VSC 536*
APPLICATION:	Early termination fees, civil penalty, unjust contract, breach of key disclosure requirements

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ORDERS

1. The Tribunal orders that the early repayment fee imposed under the loan agreement as varied between the Mr and Mrs Broadfoot and RHG Mortgage Corporation Limited be annulled.

2. The application is otherwise dismissed.

REASONS FOR DECISION

BACKGROUND

Mr and Mrs Broadfoot have had a series of loans with RHG Mortgage Corporation Ltd ("RHG").

Their evidence is they wish to pay out the RHG loans and obtain loans at lower rates. To discharge the loans with RHG they would be required to pay termination fees. They claim the termination fees are unconscionable and seek orders to annul or reduce the fees pursuant to s72(1) of the *Consumer Credit* (NSW) Code ("the Code").

Mr and Mrs Broadfoot also claim relief under ss70 and 71 of the Code in respect of the 18 July 2006 Easy Start variation as the contract was unjust, and under s30(1) of the Code that the early termination fee exceeds the actual amount payable, a declaration that RHG has imposed a prohibited money obligation under s21(1)(b), a declaration that RHG has breached the key requirement set out in s15(G). They also seek orders for the payment of a civil penalty, that the penalty be set off against any liability they have to RHG and payment of compensation.

The Loans

The parties entered into a series of loans.

1. Better Start Home Loan, February 1998 for $120,000.00 (including fees and charges of $2,926.00).
2. Easy Start Home Loan, 14 April 2005, for $65,000.00 (including fees and charges of $1351.00).
3. Variation to the Easy Start Home Loan, 3 March 2006 for $55,000.00 (including fees and charges of $690.00).
4. Variation to the Easy Start Home Loan, 18 July 2006 for $105,658.00 (including fees and charges of $295.00). This variation paid out the Better Start Home Loan.

Is the early termination fee unconscionable? Should an order be made to annul or reduce the fees pursuant to s72(1) of the Code ?

Pursuant to s72 of the Code the Tribunal if satisfied that a fee or charge payable on early termination of a contract is unconscionable, it may annul reduce or change the fee and may make ancillary or consequential orders. The effect of s72(4) is that a fee may only be determined to be unconscionable if and only if it *"exceeds a reasonable estimate of the credit provider's loss arising from early termination or prepayment, including the credit provider's average reasonable administrative costs in respect of such termination or prepayment."*

The Easy Start Home Loan as varied imposes an obligation to pay a termination fee covered by the section described in the terms of the loan as the Early Repayment Fee. After four years, the fee is calculated as an amount equal to 2 months' interest at the then current interest rate on the daily average balance owing on the loan account.

RHG provided a letter dated 2 September 2008 described as breakdown of loan payment as at that date. Included in the sums for repayment of the loan was an amount of $4,487.77 described as 'early repayment fee', $295.00 legal settlement agent's costs and discharge fee of $695.00. Although I note the submissions of RHG that no steps have been taken by Mr and Mrs Broadfoot to pay out the loan, I consider it is appropriate to determine the application under s72 of the Code by reference to that amounts disclosed in that letter. I accept that as the periods referred to elapse the manner of calculation of the early termination fee will change.

Mr and Mrs Broadfoot bear the onus of establishing the fee is unconscionable within the terms set out above.

What evidence is there of RHG's losses arising from early termination? The applicants presented no evidence in this regard. This is not surprising. Persons in the position of the applicants will not usually have access to the information necessary to ascertain the costs and therefore estimate the losses. I note the efforts of the applicants in this regard in relation to the summons they issued and attempted to have issued seeking the production of documents from RHG. It was submitted that as no evidence has been presented by the applicants they must fail as they bear the onus of proof. How the onus operates may shift. A view could be taken that if there is no material presented which establishes a reasonable estimate of loss then the loss can be determined at nil. The effect of this would be to make any fee exceed such an amount. This situation does not arise as some evidence was presented on behalf of the RHG as to some matters which they claim go to the estimate of loss. It is therefore appropriate to consider the evidence which was presented to see if it is sufficient to make a finding as to a reasonable estimate of RHG's loss.

The evidence in this regard was given by Ms Adriana Care, a solicitor in a firm that provides legal services to RHG. The material relied upon by Ms Care in preparation of the "submission" as to such costs was prepared by her based in some cases on information provided to her by Mr Geoff Kinghorn and in same cases based on information contained in documents in possession of RHG. Mr Kinghorn was formerly the chief executive officer of RHG and now acts as a consultant. Ms Care provided details of the "average" costs incurred by RHG that it would seek to recover in the Early Repayment Fee.
Figures were provided for some eight different costs associated with the loan, and an estimate was made for costs of overheads for office staff and storage and loss of profit on early termination at 10% of the other costs listed.

It was submitted that the evidence of Ms Care should not be accepted as having any probative value where she relied on information provided to her by Mr Kinghorn. While I note the limited basis on which the evidence is given it is

in effect the only evidence presented which deals with the substance of matter which may be determined to constitute a reasonable estimate of losses.

I consider it is appropriate to weigh the evidence given by Ms Care to see whether it is sufficient to constitute a reasonable estimate of the loss and determine the amount of the loss estimated.

In the submissions prepared on behalf of Mr and Mrs Broadfoot challenges were made to the evidence of each category of cost claimed as constituting a loss. These matters were not referred to expressly in the submissions on behalf of RHG.

What is the evidence of Loss? Should the early repayment fee be reduced or annulled?

It was submitted on behalf of RHG that as the loan was for 30 years if the loan is paid out early, RHG will suffer a loss in that, it will lose the interest payments for the unexpired term of the loan, and on this basis alone the evidence establishes the early repayment fee was a reasonable estimate of the loss. I do not accept this submission. The repayment of the principle sum means that RHG can lend those moneys again. It would be too artificial a constructor to say that a loss is suffered for this reason in this context. I do not take account of any unpaid interest in determining an estimate of the losses which RHG may suffer on early repayment.

I note the Code does not make it clear what must be considered in determining what is meant by “loss” in section 72 of the Code. In *Australian Consumer Credit Law* LexisNexis Butterworths at [5.320] it was suggested that loss could be interpreted in three ways, actual loss of money, as a loss of expected profit or as a loss the credit provider incurs by reducing its margin.

It is not really clear the basis on which RHG claims it will suffer loss on early termination. It appears they are claiming an actual loss of money. To the extent RHG’s evidence refers to the costs it incurs in relation to the transactions and compares them to the amount which is payable as the early termination fee I do not think this is sufficient. Apart from the issues relating to the individual items of cost claimed which go into making up the loss there is the overarching issue that RHG has not provided evidence which establishes its total costs in respect of the loan. Those costs would include the costs of funds, which in part would be reflected in the difference in the amount which RHG had to pay in interest over the interest paid by Mr and Mrs Broadfoot on their loans. In my view, it is not appropriate for the purposes of s72 to consider only part of the costs in determining whether the reasonable estimate of loss. Interest payments have been made, they reflect the income generated by the loan in the period, the costs of earning that income is not just the matters referred to in the estimate provided by RHG. If that is what was intended then a comparison could be made of those costs to the amount of interest which had been paid which would not establish that there was no loss.

For these reasons and for the reasons set out in relation to each of the costs claimed, I am not satisfied that the evidence establishes what can be considered a reasonable estimate of RHG's loss arising from termination of the Easy Start Home loan as varied as at around 1 October 2008. It is therefore open to me to find and I do that the early repayment fee is unconscionable.

Orders are sought that the early repayment fee be reduced or annulled. As I am not satisfied that the evidence discloses any reasonable estimate of loss I am satisfied the early repayment fee should be annulled.

Averages

As to those fees where an average was given, it was submitted on behalf of Mr and Mrs Broadfoot that s72 did not contemplate an average cost in respect of termination fees except in relation to overheads. Averaging was permitted in respect of establishment fees only.

I note that no specific issue is taken in the submissions from RHG as to the challenges to each category of cost. Rather the submission was made that as Ms Care's evidence was the only evidence before the Tribunal in this regard and as it was not effectively challenged it should be accepted.

Section 72 requires a reasonable estimate of the credit provider's loss. In arriving at such an estimate it may be appropriate to take an average of costs incurred in a situation where it was not known what the actual costs were. Such may be necessary for determining such costs as application processing costs for example where no record is made of actual costs and estimates are arrived at based on time which may be spent on similar transactions in determining costs. I do not reject the evidence given in respect of the cost solely because it has been based on averages. There is the matter though that the evidence did not disclose the matters which were considered in arriving at the averages and therefore it is not possible to make an assessment of whether they are arrived at in a way to be considered reliable.

Application processing

Mr Batley submitted that RHG calculated an average establishment cost in respect of the items in a. to f. with reference to similar loans to Mr and Mrs Broadfoot. They then seek to use this amount to establish loss on early termination. It was submitted this was incorrect firstly as such items relate more to establishment costs, secondly as no credit is given in respect of the application fees paid by Mr and Mrs Broadfoot, being $595.00 for the Easy Start $65,000.00 loan in April 2005 and $295.00 for the Easy Start Variation on 3 March 2006.

No credit is given for the application fees paid of $890.00 against the amount claimed of $724.00. Further no basis is provided for how the calculation of the

$724.00 is arrived at other than that, it is an average of a collection of loans the features of which and the numbers of which were not disclosed.

Ms Care's evidence at the hearing was that the calculation of the amount of loss took into account the amounts paid by Mr and Mrs Broadfoot as the loan application fee and the valuation fee.

I am not satisfied that the evidence provided by RHG is sufficient for me to make a finding that the cost of processing the application is $724.00. There is no material provided to support in reasonable detail how that figure is arrived at. Clearly there would be time costs and material costs associated with such tasks, but the evidence does not lay these out in any detail.

Valuation cost

Valuation costs were described as an average of $350.00 based on consideration of a number of contracts between RHG and third party valuers. The fee was expressed to be for an average sized security for a loan of up to $500,000.00. A valuation was obtained for the Easy Start Home Loan, 14 April 2005, for $65,000.00, the actual cost of the valuation was not disclosed. It was submitted that information would have been available to RHG and it has not been provided.

I accept the submission of the applicants. It is reasonable to expect that if there had been a valuation on the property which had involved cost then that information would have been known to RHG. I am not satisfied the evidence provided is sufficient to show that RHG has incurred an estimated cost of $350.00 for this loan.

Settlement Cost

RHG claims an amount of $453.00 as settlement costs. This is said to be calculated on a selection of loans for a couple of months prior to October 2008. Details of the loans were not provided. Mr and Mrs Broadfoot paid settlement fees for the Easy Start Home Loan, 14 April 2005, of $150.00 and for the Variation to the Easy Start Home Loan, 3 March 2006 of $175.00.

Again the evidence of Ms Care does not provide much detail to establish how the cost is arrived at. In cross examination, her evidence was that an average was arrived at for the cost by looking at their costs including solicitors' costs from a "snapshot" of contracts for securities of less than $500,000.00 entered into in the few months prior to 1 October 2008.

This is insufficient material to reach a finding that $453.00 is a cost which RHG is likely to incur on the settlement of the loan.

Mortgage insurance

It was submitted that the actual amounts paid for mortgage insurance by RHG would have been known and therefore it is inappropriate to rely on an

estimate. It was further submitted a fee of $3,500.00 would not reflect the actual costs. Mr and Mrs Broadfoot paid the mortgage insurance premium of $1,500.00 for the Better Start Home Loan, February 1998 for $120,000.00. Further correspondence from RHG suggests the premium for $65,000.00 had been $150.00 in around March 2006. There should have been no additional premium for the Variation to the Easy Start Home Loan, 18 July 2006 for $105,658.00 as the premium would have been paid when the loan was taken out in 1998.

Further Ms Care was unable to say how the premium was calculated.

I accept the submission. If mortgage insurance was paid for the loan then it would be reasonable to expect that RHG would have the information necessary to ascertain the amount paid. If no insurance has been obtained then the cost of such insurance cannot be considered part of the amounts to be considered in arriving at an estimate of the loss arising from early termination.

Up-front securitisation fee

Ms Care's evidence was that the securitisation fee was calculated on 0.15% of the total value of the loan. I note the submission and I accept that Mr and Mrs Broadfoot paid a securitisation fee of $95.00 for the Easy Start Home Loan, 14 April 2005, for $65,000.00, and that 0.15% of that is $97.50. There does not appear to be any basis for claiming that the fee would be $336.87 and to include this amount in the estimate of loss.

Up-front franchise/broker fee

It was noted that the evidence given by Ms Care as to these fees was based on franchise agreements seen by her. These provided for payment of a fee based on 0.2% of the loan amount. It was not reasonable to expect payment of that fee to be recovered over the first four years of the loan.

There is no explanation by RHG as to why the amount of any fee actually paid for the loan could not be disclosed. However the evidence does provide detail of franchise agreements currently in place and this is probably sufficient to make a finding it was payable and for the amount of $448.56. I do not accept the submission as to recovery of this amount in the early period of the loan. I accept it is a payment required to be made by RHG and therefore can be included in the amount relied upon for making an estimate of loss.

Costs of servicing the loan

The evidence of RHG was that the claim for costs of servicing the loan was based on an average of 0.17% of the loan amount based on the average cost of funding estimated by Mr Kinghorn. I accept in the absence of any of the documents or material on which the average was based it is not possible to determine whether this reflects the true cost. Further no account is taken of the annual service fee paid by Mr and Mrs Broadfoot and in this regard the loss is overstated.

I note the printout of the loan payments shows the debiting of the account for an amount of $300.00 on an annual basis. Even on the figures supplied by RHG the amount which would be relevant for determining loss would have to be reduced to reflect that payment.

Further the amount calculated of $381.27 per annum seems to have been based on the balance of the loan current at 30 September 2008, of $219,842.20 and applied for the whole term of the loan without having regard to the fact that the loan amount has varied over time. Applying that rate on an annual basis would give a figure close to the amount paid by Mr and Mrs Broadfoot. I am not satisfied that this is an amount which can be considered in determining the loss suffered.

Ongoing costs in relation to the trail paid to the loan writer

It was submitted that the trail paid to the loan writer of 0.25% for the life of the loan should not be considered a cost that is only incurred in the early period of the loan and it is therefore inappropriate to treat it as a loss resulting from early repayment. Such a payment would be reflected in the margin between the cost of funds to the lender and the interest rate charged to Mr and Mrs Broadfoot.

I do not accept this must be characterised as a loss which occurs only in the early period of the loan. It is a cost which is payable by RHG and is payable out of the funds it receives for the loan. I accept it is a cost which can be relied upon in determining the amount of loss.

Again the amount calculated of $560.69 appears to be based on the balance of the loan current at 30 September 2008 instead of being calculated on the balances as per the amount loaned in April 2005 and each of the variations. Making the calculation on one year at $65,000.00 and two at $224,000.00 gives a figure of $1282.00 which is a slight overestimate of the amount actually due.

Overheads in relation to office, staff, storage etc.
Loss of profit

The submission notes that no figures were provided for these amounts only an estimate based on a percentage of the other costs, at a rate of 10%. It was submitted in the absence of detailed evidence of the losses the estimates should not be accepted.

I accept the submission. The material provided does not provide a sufficient basis on which I am able to find that this represents a reasonable estimate of such costs.

Fee paid to Originator

It was submitted that the early termination fee does not reflect any losses to RHG but rather it arises as a consequence of the obligation of RHG to pay compensation to the originator. The originator is not a party to the loan contract. It cannot be said that the obligation to pay that amount is not the same as the loss on early termination.

It was submitted that RHG must establish that the early termination charges represents the amount payable to the originator and that that amount is in fact paid taking account of any discount or rebate arrangement. If the amount in fact payable to the originator is less than the early termination fee sought to be imposed on Mr and Mrs Broadfoot then it is a breach of s21 to impose the charge, and it would render RHG liable to a civil penalty.

RHG submit that there is no evidence to support the claim that the early repayment fee should be seen not as representing a loss to RHG but a particular arrangement with RHG's originator.

Although I have found that the early repayment fee exceeds a reasonable estimate of RHG's loss, I am not satisfied that is the case because of any obligation RHG has to make payment to the originator. That obligation, while it is referred to in the Variation to the Easy Start Home Loan, 18 July 2006 as part of the amounts to be paid by RHG on early termination, it is not relied upon by RHG in arriving at the estimate of its losses. Why it has not done so is not clear, but that is not for me to deal with. Further, I am not satisfied that it is a fee of the type contemplated in s21 of the Act. It is difficult to understand why the details in respect of the early repayment fee appear under the words "originator charges (for payment to the originator)". However I am not satisfied that those words are sufficient to make the fee into something other than described in the text which follows the words "early repayment fee".

Should a declaration be made that RHG has breached the key requirement set out in s15(G) of the Code?

It was submitted that RHG appears to have rolled the costs of the valuation and mortgage insurance into the early termination fee instead of disclosing those costs as costs payable by the borrowers in the Financial Information Table. The inclusion of the costs in the early termination fee means that they are payable if borrowers terminate the contract before 4 years has expired. The failure to disclose the fees is a breach of s15(G) of the Code and renders RHG liable to payment of a civil penalty.

It was submitted on behalf of RHG that there has been full disclosure of all credit fees and charges payable under the contract and the disclosure requirements of s15(G) have been met.

I do not accept the submissions on behalf of Mr and Mrs Broadfoot that there has been a failure to disclose the credit fees and charges in relation to these items. It is open to a credit provider to make separate charges for items such as valuation costs and mortgage insurance, RHG has done this in respect of some of the loans, provided there has been appropriate disclosure. The credit

provider is not in my view obliged to disclose as a separate amount all of the costs it incurs in providing the credit, it is obliged to disclose the costs and fees it is requiring the debtor to pay. The Code permits a credit provider to charge fees such as early repayment fees provided they are disclosed. There is no dispute that the fees were disclosed. I do not consider that including such amounts in seeking to establish the losses which would be incurred on early termination means that there has been the requisite failure to comply with s15(G). This part of the application is dismissed.

Was the 18 July 2006 Easy Start variation unjust?

The claim was made that the entry into the Variation to the Easy Start Home Loan, 18 July 2006 for $105,658.00 was unjust. They wanted to obtain a further advance under their Better Start Home Loan but were told the product was no longer offered, it was incompatible with the computer program and there would be break fees as the interest rate was fixed. They were disadvantaged in that the principal amount which had not been the subject of early repayment fees became subject to such a fee.

It was submitted the evidence of Ms Care that Mr and Mrs Broadfoot were better off by reference to the table at annexure “V” should not be accepted. Ms Care was not able to explain how the table was prepared, the assumptions on which it was based and no evidence was given as to the interest rate from time to time for each loan.

The submission on behalf of RHG was that the entry into the Variation to the Easy Start Home Loan, 18 July 2006 was not unjust. RHG made all disclosures required under the Code. Mr and Mrs Broadfoot’s evidence was that the interest rate at the time was lower than the Better Start Home Loan.

I am satisfied that there have not been the claimed contraventions of the disclosure requirements of the Code. The evidence shows that Mr and Mrs Broadfoot had time to read and consider the loan agreement which was sent to them. It was Mrs Bradfoot’s express evidence that they read and understood the basics like the loan amounts and the interest rates. They did not obtain any advice.

I note the evidence given by RHG that the variable interest rate for the different types of loan has differed in the period. The interest rate for the Better Start Home Loan, February 1998 was 7.52% and the interest rate for the Variation to the Easy Start Home Loan, 18 July 2006 was 6.89%. Evidence was not provided which showed the difference remained consistent for the whole term of the loan, but a difference of similar amount was in place in January 2008 as set out in the notices of change in interest rates, though the difference appears to have reduced. However I note the evidence was insufficient to establish that the amount of interest which would have been paid if the amount outstanding under the Better Start Home Loan 1998 had

not been transferred to the Variation to the Easy Start Home Loan, 18 July 2006.

Section 70 of the Code gives the Tribunal the power to reopen the transaction that gave rise to the contract if satisfied that in the circumstances relating to the contract at the time it was entered into the contract was unjust. The main submission on behalf of Mr and Mrs Broadfoot appears to be that no effort was made to ensure that they understood they were changing from a loan which was not subject to an early repayment fee to one which was, matters which are relevant to the considerations under s70(2)(i) and (k) of the Code.

The evidence is clear that this change was not the subject of any particular discussion or notice other than that by virtue of the disclosures in the loan agreements which were sent to the parties. I note the discussions Mrs Broadfoot had with Mr Sullivan. I also note evidence of Mr and Mrs Broadfoot as to their education and work experience. They had already entered into a loan agreement which made provision for an early repayment fee, the Easy Start Home Loan, 14 April 2005. When I consider all the matters referred to in s70(2) I am not satisfied that in the circumstances the loan contract was unjust.

Orders made accordingly.

M Balding
Senior Member
Consumer Trader & Tenancy Tribunal

14 August 2009