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By email: [nathan.pringle@treasury.gov.au](mailto:nathan.pringle@treasury.gov.au)

Tom Dickson  
Manager, Bank Competition and Funding Unit  
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The Treasury  
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Dear Mr Dickson

### **Post Implementation Review of Ban on Mortgage Exit Fees**

The Consumer Action Law Centre (**Consumer Action**) welcomes the opportunity to contribute to the Post Implementation Review of the ban on mortgage exit fees.

Briefly, this submission

- supports the existing ban on mortgage exit fees;
- argues that available evidence from the RBA indicates the fee is achieving its objectives; but
- argues that the ban is being undermined by clawback provisions in broker contracts.

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 offers free legal advice, pursues consumer litigation and provides financial counselling to vulnerable and disadvantaged consumers across Victoria. 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.

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## Continued support for the ban

We continue to support the ban on exit fees as introduced through the *National Consumer Credit Protection Amendment Regulations 2011 (No 2)*.<sup>1</sup> The fees that these regulations prohibit are anti-competitive, because:

- they create a disincentive to switch: a borrower is less likely to switch to a more competitive loan if threatened with thousands of dollars in exit fees. This is a poor outcome for the consumer if switching would have saved them money in the long run, and it also reduces the ability of lenders who invest in creating a better product to attract business, and rewards those with an inferior product but high exit fees;
- they conceal the true cost of a mortgage by expressing a cost as a contingent fee when in fact the typical borrower will end up paying it: ASIC's *Review of Mortgage Entry and Exit Fees*<sup>2</sup> noted that 2006 research by Fujitsu Consulting and JPMorgan found that "the average Australian mortgage is terminated or refinanced within approximately three years" and 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)". This suggests that it may be the average (rather than the exceptional) customer who pays an early exit fee. To the extent that these fees represent genuine costs, charging them as contingent fees allows lenders to advertise headline interest rates and fees which are deceptively low; and
- they allowed lenders to 'back-end' some of their fees where they are less visible and so less open to competitive pressure.

Importantly, the exit fee ban does not prevent lenders from charging any fee at the point of establishment (or indeed reasonable 'break fees' which reflect actual losses when a consumer exits a fixed term loan early). Where exit fees represented a genuine cost, the ban only requires that lenders charge them at establishment or through the headline interest rate or ongoing fees, where they are more susceptible to competitive pressure.

## Evidence of effectiveness

Available evidence suggests the exit fee ban has reduced the amount of fees paid by home loan borrowers.

The Reserve Bank of Australia's publication *Banking Fees in Australia* reported that the exit fee ban has contributed to a reduction in home loan fees. It is notable that there has been an overall

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<sup>1</sup> While we supported these regulations, broadly we raised some concerns with the drafting of the some parts of the regulation in our submission to the exposure draft, which can be found here: <http://consumeraction.org.au/submission-national-consumer-credit-protection-amendment-regulations-2011-exposure-draft/>. We note that our concerns with the definition of "break fee" were addressed in the final regulation.

<sup>2</sup> ASIC's report is available at [http://www.asic.gov.au/asic/pdf/lib.nsf/lookupbyfilename/rep\\_125\\_review\\_of\\_mortgage\\_entry\\_and\\_exit\\_fees.pdf/\\$file/rep\\_125\\_review\\_of\\_mortgage\\_entry\\_and\\_exit\\_fees.pdf](http://www.asic.gov.au/asic/pdf/lib.nsf/lookupbyfilename/rep_125_review_of_mortgage_entry_and_exit_fees.pdf/$file/rep_125_review_of_mortgage_entry_and_exit_fees.pdf).

reduction in the amount of fees paid despite an increase in the number of home loans issued, and that the removal of exit fees has not led to other home loan fees being increased.

For example, the June 2013 edition of *Banking Fees in Australia* (which is based on information provided by banks for the financial year ending in 2012) found

The slight decline in housing loan fee income occurred despite the 5 per cent increase in mortgage lending over the year. This divergence partly reflected the decision by a number of banks to waive application and other fees. It also resulted from a continued fall in exit fee income following the Federal Government's ban on exit fees on variable rate home loans in July 2011. In the lead-up to the ban there had been speculation that lenders would increase other fees to compensate for the potential loss of income. However, average fees (excluding exit fees) charged on variable rate mortgages discharged after three years have declined slightly for both bank and non-bank lenders since the ban was implemented.<sup>3</sup>

This followed a similar remarks in the 2012 edition of the same report, which found that

Total fee income earned on housing loans fell by 11.3 per cent in 2011, after having grown at an average annual growth rate of 11.4 per cent between 2005 and 2010. The fall in housing loan fee income occurred despite the surveyed banks' outstanding housing loans growing by 8 per cent. This fall was mainly a result of a decline in account servicing and 'other' fee income. Much of this decline owed to falls in exit fees charged by banks for the early termination of variable-rate mortgages. These fees were banned by the Federal Government from 1 July 2011 on new housing loans, although some banks abolished these fees prior to this date. There was also a decline in income from break fees.

This strongly suggests to us that the ban on exit fees has achieved its objective of improving competition in the home loan market—not only are costs of home loans more transparent (because they are no longer hidden in exit fee costs) but the added transparency has driven down costs. Further, the ban has not negatively impacted on access to credit or business growth, given that mortgage lending overall has increased since the ban on exit fees came into effect.

This explanation is supported by similar findings of a review of credit card fee reforms in the United States of America. These reforms limited a number of non-transparent or "back-end" fees. The study had presumed that in response to limiting fee income that banks would simply raise interest rates. However, the review found that the regulation

reduced overall borrowing costs to consumers by an annualised 2.8% of average daily balances, with a decline of more than 10 per cent for consumers with the lowest [credit reporting] scores.

The researchers found that this reduction was not offset by an increase in interest charges or a reduction in access to credit.<sup>4</sup> The researches stated that this was because providers were still competing on interest rates and could lose business if they appeared to be more expensive than their competitors. We believe that the ban on exit fees is likely to have a similar effect.

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<sup>3</sup> Jessica Pratten, 'Banking Fees in Australia', *Bulletin: June Quarter 2013*, pp 39-44, at p 41. Accessed 11 November 2013 from <http://www.rba.gov.au/publications/bulletin/2013/jun/pdf/bu-0613-5.pdf>.

<sup>4</sup> Agarwal, Chomsisengphet, Mahoney and Stroebel (2013) 'Regulating Consumer Financial Products: Evidence from Credit Cards'. Accessed 11 November 2013 from [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=2330942](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2330942)

The alternative explanation that has been proposed is that these costs have instead been shifted to business loans, as both the 2012 and 2013 editions of *Banking Fees in Australia* report an increase in fees in business loans over the same period they were falling in residential loans.<sup>5</sup> We do not believe this argument is made out in the analysis provided in *Banking Fees in Australia*.<sup>6</sup> However, even if it were the case that income from exit fees is now being collected through business loans, it supports the argument that disallowing non-transparent fees enhances price competition. It is notable that both the 2012 and 2013 editions report a fall in the cost of business deposits due to vigorous competition in this area.<sup>7</sup>

### **Loophole: broker clawbacks**

We are aware that some borrowers are effectively being charged exit fees on mortgages through broker clawbacks. An article by Australian Broker Online reports that 'brokers are well within their rights' to claw back establishment fees from borrowers despite the ban on early exit fees and quotes Jon Denovan of Gadens Lawyers suggesting that more brokers are becoming comfortable with the practice:

I think there is a changing view about the ethics of getting clawback from borrowers. You must remember that before, borrowers are liable to pay deferred establishment fees or exit fees. Those fees have gone now, but borrowers are still not having to pay big establishment costs and so they are not paying establishment costs, somebody is subsidising it. And the person who is subsidising it is the lender if the loan runs long enough or you, if it doesn't run long enough, you the broker. So it's only fair enough that you should be able to claw that back.<sup>8</sup>

The same article goes on to advise that this kind of clawback is legal as long as the right to claw back is disclosed upfront. Consumer Action contests this proposition as it fails to consider the impact of the prohibition on unfair contract terms.

Consumer Action has provided advice to at least one consumer in this situation. The consumer entered a contract with a broker in November 2011 to organise a loan to refinance his existing mortgage. Our client was unsatisfied with the service provided by the broker and wanted to refinance the loan again so as to no longer be associated with the broker. The client ended the contract arranged by the original broker, entering a new contract in February 2012. The broker later contacted the client advising that their commission had been clawed back by the lender and so the broker was in turn clawing it back from the borrower. The amount claimed by the broker was in excess of \$2000, and requested within seven days.

We believe that a term allowing this kind of clawback is against the spirit, if not the letter of the prohibition on mortgage exit fees. The purpose of the regulation was to prevent lenders from

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<sup>5</sup> See for example comments by the Australian Chamber of Commerce and Industry in Clancy Yeates, 'Fees contrast as exit ban bites', *The Age*, 22 June 2012. Accessed 11 November 2013 from <http://www.theage.com.au/business/fees-contrast-as-exit-ban-bites-20120621-20qv5.html>.

<sup>6</sup> For example, the largest rise reported in the 2012 edition was to fees on bank bills, itself driven by the impending Basel III standards (see p 46). The 2013 edition reports a fall in exception fees and 'other' fees on business loans. Business loan exception fees fell by around 24% in the 2011 edition.

<sup>7</sup> See page 46 of each edition.

<sup>8</sup> Anna Temple (nd) 'Clawback Commission Confusion: What the Law Says', *Australian Broker Online*. Accessed 11 November 2013 from <http://www.brokernews.com.au/tv/clawback-commission-confusion-what-the-law-says-178660.aspx>

'deferring' establishment fees and holding them over a borrower as an exit fee to prevent switching. It makes little sense to allow the same conduct simply because a broker is involved. If Government is considering reform to the regulations it should specify that the ban also prohibits clawback terms in broker contracts.

Please contact David Leermakers on 03 9670 5088 or at [david@consumeraction.org.au](mailto:david@consumeraction.org.au) if you have any questions about this submission.

Yours sincerely

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