AUSTRALIAN BANKERS' ASSOCIATION INC.

Ian Gilbert
Policy Director

Level 3, 56 Pitt Street
Sydney NSW 2000
Telephone: (02) 8298 0406
Facsimile: (02) 8298 0402

28 February 2011

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

Email: banking@treasury.gov.au

Dear Mr Lonsdale,

Exposure Draft - National Consumer Credit Protection Amendment Regulations 2001

The Australian Bankers' Association (ABA) is the peak national body representing banks that are authorised by the Australian Prudential Regulation Authority to carry on banking business in Australia and to describe themselves as banks.

The ABA's membership comprises 23 banks. Members include the four major Australian banks, regional and smaller Australian banks and a broadly representative range of international, retail, commercial and wholesale banks operating in Australia.

The ABA appreciates the opportunity to comment on the proposed regulations by which it is proposed to ban the charging of exit fees on certain consumer credit facilities.

The proposed regulation 79A defines the scope of the proposed prohibition.

The prohibition is intended to cover a fee or charge payable on or in relation to the termination of a credit contract (other than a break fee or discharge fee) under a credit contract that is secured over residential property or is provided wholly or predominantly to purchase, renovate or improve residential property or for refinancing that type of consumer credit.

In this submission we will describe the prohibited fees or charges as "home loan exit fees".

It is noted that the authority for the exercise of this regulation making power is found in section 31 of the National Credit Code (NCC).

1. Policy considerations for prohibition of home loan exit fees

The Government's proposal to ban home loan exit fees has received considerable publicity since it was announced and more recently on the publication of internal Treasury working papers that were obtained under Freedom of Information legislation (Treasury materials).

The ABA notes that, to the best of its knowledge, this is the first time that a government has sought to exercise this regulation making power under either section 31 of the NCC or its predecessor section 29 of the uniform Consumer Credit Code.[1]

The ABA notes that both the NCC and the unfair contract terms provisions of the Australian Securities and Investments Act 2001 (ASIC Act) and the Australian Consumer Law Act 2010 provide a means by which the home loan exit fees proposed to be banned can be challenged.

None of those statutory provisions contemplates 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 is a form of price control that amounts to an absolute prohibition of home loan exit fees irrespective of their justification.

It is noted in the Treasury materials there is recognition of a cost to a credit provider resulting from an early termination of a consumer credit contract because there was the proposal that home loan exit fees could be charged within the first 12 months of the credit facility. There is no explanation as to why this would be no longer the case. Further, in ASIC's Regulatory Guide 220 with respect to early termination fees, ASIC outlined the fact that a deferred establishment fee is considered to be a fee payable on early termination, and set out what kind of costs ASIC considered could be recovered through early termination fees. This is another clear recognition that there are credit provider costs associated with early termination.

Some of the likely impacts of the proposed prohibition that are identified in the Treasury materials are that the price to consumers for possibly more transparency and simplicity in the costs of the particular home loans proposed to be affected are that the recovery of credit providers' costs of early termination are likely to be recouped by a combination of higher up-front fees and interest rates.

---

[1] Tasmania amended its Consumer Credit (Tasmania) Regulations by the Consumer Credit (Tasmania) Amendment Act 2003 by inserting a new regulation 18A with effect that a credit contract may not provide for any fee or charge for the purpose of determining the value of household goods. Section 29 of the Consumer Credit (Tasmania) Code was not relied upon.

The Treasury materials observe that: -

- Consumers may be worse off if exit fees simply move to increased establishment fees or ongoing fees;
- If as a result of the prohibition establishment fees and other fees and charges are used to recoup lending costs, many of these fees and charges may be unavoidable unlike exit fees;
- There is a risk that removing exit fees would reduce the transparency of credit providers fees resulting in greater cross-subsidisation across customers so that customers that rarely switch institutions are likely to be cross-subsidising those that do on a frequent basis;
- If establishment and ongoing fees are increased this will impact first home buyers seeking to enter the housing market for the first time and conflict with the Government's goals of more affordable housing;
- If credit providers cannot recover their costs through home loan exit fees higher levels of mortgage switching could adversely impact the recovering mortgage loan securitisation market and associated costs due to mortgage book uncertainty.

Apart from the Treasury materials, the ABA is concerned that there is no accompanying regulatory impact assessment of the proposed regulations to ensure that the Government is meeting best practice regulation guidelines to which the Government has subscribed.

In addition, prohibition of exit fees, particularly those known as "deferred establishment fees" (DEF) that generally do not apply after about four years into a loan term, is likely to impact smaller lenders despite the fact that the DEF is a genuine cost recovery measure. For the majority of banks, the DEF was established as a response to reduced upfront legitimate costs of taking on a new credit contract and mortgage and to compete with the DEF that was initiated by non-bank lenders to reduce the costs of borrowing for consumer credit.

Use of the regulation making power under section 31 of the NCC also means that the Parliament has no prior opportunity to formally consider the proposed prohibition.

The ABA believes that the policy decision to prohibit home loan exit fees should be reconsidered, not rushed as it appears it will be, and balanced by a proper economic and market impact assessment that would include alternative options to the outright prohibition.

2. Specific comments on the regulations

2.1 Definition of Home Loan and other terms in 79A(1) and (2)

The drafting of this term means that it will have a very wide scope and will capture a range of credit contracts that are merely incidental to residential property including unsecured credit contracts.

2.1.1 The use of the term "credit contract"

The use of the term "credit contract" in both 79A(1)(a) and 79A(2) suggests that everything which is covered by the NCC (home loans, credit cards, personal loans etc) is covered in this expression which will apply to any credit contract

a) that is secured by direct mortgage or by a guarantee secured by mortgage over residential property, or

b) under which the credit provided is wholly or predominantly used for the purchase, renovation or improvement of residential property or for the refinancing of that credit irrespective of whether the credit is secured over residential property.

2.1.2 New terminology

The ABA is concerned that the proposed regulations introduce new terminology to the NCC. The ABA recommends that terms such as "home loan", "loan" and "cost of funds" should be avoided.

Further, 79A(1) refers to "fee or charge" which the ABA considers is too wide and uncertain. To avoid possible unintended application, the better reference would be to use the term "<u>credit</u> fee and charge" which is defined in s204 of the NCC and which has a specific meaning.

2.1.3 Use of "or" in 79A(2)

The ABA recommends that the disjunctive use of "or" when first used after 79A(2)(a) should be replaced with "and" so that at most the scope of the meaning of home loan is confined to credit contracts secured over residential property.

Without at least this limitation credit provided for miscellaneous purposes that are related to home or investment property renovation or improvement purposes would be covered, for example:

a) an unsecured personal loan to pay for painting

b) use of a credit card to instal a new kitchen or bathroom or the raw materials involved,

where there may be outstanding fees and charges (e.g. an annual fee) due to the credit provider or other payments that accrue for payment "on or in relation to" the termination of the credit contract.

However, even with this limitation the scope of the definition is still very wide.

For example, it would capture credit secured over residential property provided to purchase a motor vehicle drawn down under an existing home loan or residential property investment loan or a separate secured personal loan.

2.1.4 Clause 79A(1)(b)

The ABA notes that the expression "in relation to" is wide and should be limited to fees and charges that are payable as a direct result of the termination of the contract.

In this respect, regulation 79A(1)(b) would include fees and charges not actually connected to the credit contract (i.e. fees that coincidently are payable "on" termination).

The ABA recommends that 79A(1)(b) is changed to read "is payable **under the credit contract** on or in relation to the termination of the credit contract".

But even with this amendment, 79A(1)(b) is still wide and it is queried why the wording in NCC s78(1)(c) has not been replicated here.

Unlike the NCC the termination is not expressed to be premature and could include a fee or charge that is payable where the credit contract simply matures.

2.1.5 Enforcement expenses not covered in 79A(1)(c)

The ABA recommends that enforcement expenses should be included in the exception in this sub-clause. It is noted that the NCC provides that a credit provider must only charge enforcement expenses that are reasonably incurred.

2.1.6 Refinancing

Further, in 79A(2)(b)(ii), with respect to refinances, there will be times that the refinancing credit provider will not know the "purpose" for which the original credit was provided. This will be of particular concern if the current definition of "home loan" is retained with the disjunctive "or" referred to above but still would be a problem even if "and" is used.

One suggestion is for the regulation to provide for a credit provider having the option to obtain a "non-home loan" declaration from the customer. The format of such a declaration would depend on the final definition of "home loan".

For the avoidance of doubt, it should be clear that the reference to "residential property" in the proposed regulations reflects the exemption in regulation 65C of the National Consumer Protection Regulation 2010 with respect to credit provided for investment in residential property.

2.2 Definition of break fee

The ABA refers to the expression "cost of funds" and recommends that this expression is defined and further consultation on the definition is undertaken.

The context of what are "cost of funds" for a credit provider vary according to the particular sources of funds of a credit provider and is complex and not well understood in the community. There are substantial commercial in-confidence considerations in relation to an individual credit provider's "cost of funds" and significant legal implications should the Government proceed with its proposed price signalling legislation that is intended to apply to the "banking sector".

Further, '*only*' should be removed from the break fee definition. Based on the current drafting, it appears that a credit contract would need to have two separate "break fees", i.e. a break fee that *only* relates to early termination of the credit contract, and a separate break fee that relates to partial discharges. Removing "only" would allow the "break fee" to cover both full and partial discharges.

2.3 Definition of discharge fee

The last sentence in the Explanatory Statement (ES) under "discharge fee" should be deleted.

The ES notes that this fee should be the same regardless of whether the customer terminates the contract early or on maturity yet 79A(4) notes that this is the average reasonable administrative cost of terminating the credit contract.

Clearly, if the customer is ending a contract early, additional administrative effort may be required, for example, the calculation of payout figures, arranging and attending settlement, that would not be required if the contract ends at the end of its term and the debt has been fully paid.

For this reason 79A(3) should refer to ".....reasonable administrative costs of terminating the credit contract and discharging a related mortgage." Without the added words, the credit provider may only recover costs relating to the actual credit contract but not the costs associated with the discharge of the mortgage.

For the same reason in 79A(4) the ABA recommends that this definition should provide that "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 and discharging the related mortgage."

Further, the ABA draws attention to s.21(2) of the NCC that provides -

> *"Nothing in this section prevents the* credit provider *from retaining or requiring payment of fees or charges incurred before the termination and which would have been payable under the* credit contract*".*

It should be clear that the rights of a credit provider under this section of the NCC are not affected where, for example, the customer terminates the credit contract before drawdown.

The ABA recommends that the definition of discharge fee should be further amended to include reasonable third-party costs, such as those relating to mortgage managers and legal costs, and suggests the following, that in part, (underlined) uses wording similar to s32 of the NCC

"...*only reimburses the credit provider for reasonable administrative cost of terminating the credit contract, including* ***reasonable*** *fees or charges payable by* *the debtor for an amount payable or to reimburse an amount paid by the credit provider to another person, body or agency*".

Finally, it is noted that there is a significant difference between 79A(4) s 78(3) of the NCC and 79A(4) refers to "class of credit contract" whereas s78(3) refers to "class of contract". The limitation of the class to "credit contracts" would seem to prohibit a credit provider from working out the average reasonable administrative cost across its whole portfolio, which may include both regulated and non-regulated loans.

2.4 Definition of fixed loan

The ABA recommends that this definition is amended so that a fixed loan is described as a "fixed rate loan" where "......the annual percentage rate is fixed over an agreed term for the whole or part of the amount due under the credit contract."

3. Transitional issues

There is a potential transitional difficulty if the proposed prohibition on home loan exit fees extends to the contract term that provides for the recovery of these fees.

The proposed application of the prohibition is in respect of a contract **entered into** on or after 1 July 2011. This means that offers made to customers before 1 July 2011, i.e. before the contract is entered into, and are accepted on or after 1 July 2011 with effect that the credit contract come into existence at that time could place the credit provider in breach of the prohibition if the offer document contains the prohibited term.

Even if on its true construction the proposed regulation does not prohibit inclusion of the term in the credit contract, but simply reliance on the term for the recovery of the proscribed fee or charge, the credit provider may be in breach of the Code on the basis of the Code's contracting out prohibition or that the credit provider had engaged in deceptive or misleading conduct in relation to its provision of financial services under the ASIC Act.

The ABA recommends that a transitional provision is included in the regulation to deal with these "in flight" offers and for industry to amend their standard form terms and conditions with respect to "home loan" credit contracts. Not all consumer credit facilities are to be affected by the proposed regulation.

There is a precedent for this approach under the NCCP Act with respect to the commencement of the responsible lending obligations for banks and other ADIs and registrable finance companies on 1 January 2011. In that case a period for 3 months in the lead up to the commencement was allowed to take account of "in flight" offers in circulation that were at risk of acceptance after 1 January 2011. The transitional period is to end on 1 April 2011.

Alternatively, regulation 79A(1)(a) could be amended so it refers to a credit contract document for a "home loan" that is issued on or after 1 July 2011 as this could overcome the problem of "in flight" offer documents issued prior to 1 July 2011 but not accepted and returned to the credit provider until after 1 July 2011.

This would allow time for credit providers to amend and update documents at the same time as other required changes to the NCCP.

Credit providers will require sufficient time to make necessary changes to the relevant standard form credit contracts. A mere three months (assuming the regulations are Gazetted by end March 2011) would not be sufficient time to do this, particularly as the scope of the proposed prohibition is wider than simply home loan contracts as these facilities generally are presently understood. There is a much wider class of credit contract contemplated under the regulations.

For example, under the NCCP Act credit providers have two years to identify and amend specific documents with the inclusion of the credit provider's Australian Credit Licence number.

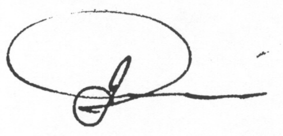
Further, while the regulations are intended to apply to loans entered on and after 1 July 2011, it is unclear whether they are intended to apply where a "restructure" of a "home loan" occurs after 1 July 2011 and a new credit contract is required. Examples include variations that are internal refinancing, split loans, changes in the amount borrowed or a change of borrower.

Section 40 of the NCC provides that changes to existing credit contracts are not to be treated as creating new credit contracts. It would seem inconsistent that a variation that was chosen to be effected by the creation of a new credit contract, but in substantially the same terms as the original contract, should then become subject to the prohibition.

4. Concluding comment

The ABA repeats its concern that there has been insufficient economic and market analysis of the proposed regulations and particularly the impacts the proposed prohibition may have on credit providers both large and small and their customers.

Yours sincerely



Ian Gilbert

c.c. Justin Douglas, The Treasury