Post-Implementation Review

Prohibiting Early Termination Fees for New Home Loans from 1 July 2011

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EXECUTIVE SUMMARY

1. The ban on early termination fees (ETFs) for new mortgages was part of the previous Government's Competitive and Sustainable Banking System (CSBS) reforms announced in December 2010.

2. The ETF ban prohibits lenders from inserting a clause into a mortgage contract whereby the borrower is charged an ETF ('credit fee or charge' in the legislation) if the borrower terminates the loan within a specific time period. The prohibition does not apply to a discharge fee, a break fee for a fixed rate loan, or a fee for termination of a contract before any credit is drawn.

3. The ETF ban was designed to address several perceived problems: ETFs reduce refinancing activity in the mortgage market; many borrowers do not accurately account for the cost of ETFs because they focus on short run costs (for example, loan establishment fees) rather than long run costs; after the GFC there was an increase in borrower complaints around the costs associated with refinancing; and, borrowers faced significant time and monetary costs in challenging ETFs that might be deemed 'unconscionable'.

4. While some lenders had abolished ETFs in the 12 months prior to the ETF ban, it is unclear whether the market would have further eliminated ETFs without Government intervention.

5. The then-Government chose to ban ETFs effective 1 July 2011.

6. The impact of the ETF ban on borrowers has been mixed. The ETF ban has provided more transparency around loan products and increased borrowers' ability to take advantage of savings offered through refinancing. Borrowers have also not encountered higher fees in other parts of home-loan contracts to compensate for ETFs. However, some lenders used high ETFs to enable them to offer competitive interest rates. With these products no longer possible borrowers who would have previously taken advantage of these products (and would not have refinanced) will not have benefited from the ETF ban.

7. The impact on lenders has also been mixed. It is calculated that the industry experienced a compliance cost of approximately $76,180 on average per year over 10 years, plus the unquantified cost of complaints from people who misunderstood the nature of the ban. Major banks have continued to increase market share relative to non-Authorised Deposit-taking Institution (ADI) lenders, although this trend preceded the ban and is more likely to be due to the effects of the Global Financial Crisis (GFC) on non-ADI lenders' business models. Additionally, ADI's fee income from housing declined after the ETF ban, however, total fee income continued to grow.

8. With respect to competition, it is difficult to isolate the impact of the ETF ban from other factors affecting competition in the mortgage lending market. Refinancing activity, loan discounting and bank fee data are consistent with a period of sustained competition in the mortgage market in the years since the ban was introduced. Nonetheless, it is not possible to suggest what (if any) proportion of this sustained competition is due to the ETF ban. While market concentration has increased, as noted above, this was part of a broader trend of change in market structure following the GFC.

9. While there are few clear impacts of the ETF ban, and many that are impossible to disaggregate from other market forces, continuing the ETF ban remains appropriate at this time. This is because: it provides increased transparency of mortgage products, reducing the risk of borrowers choosing sub-optimal products; it has decreased potential barriers to switching mortgage lenders, increasing the potential for borrowers to exert competitive pressure on lenders; and there are minimal ongoing compliance costs from continuing the ETF ban.

INTRODUCTION

BACKGROUND

10. On 23 March 2011, the previous Government enacted legislation that prohibited ETFs for new home loans entered into from 1 July 2011. The change was implemented as the National Consumer Credit Protection Amendment Regulations 2011 (No 2).

11. The prohibition does not apply if the fee or charge is a discharge fee, a break fee for a fixed rate loan, or if it is for the termination of a credit contract that is terminated before any credit has been provided under the contract.

12. The legislated definition of a break fee for a fixed rate loan includes the condition that it is the 'difference between the fixed interest rate and the prevailing rate at which credit is provided by the credit provider under that class of credit contract'. Thus, a break fee that, in addition to recovering the lender's loss, penalises a borrower for leaving a fixed rate early would also be prohibited under these amendments.

DEFINITIONS

13. Fees associated with exiting a mortgage can be broadly categorised as:

- **ETFs**, which are fees charged by a lender if a consumer terminates a mortgage (either repaid in full or refinanced with another lender) within a specified period (usually between one and five years into the mortgage).
  - ETFs are also referred to as 'deferred establishment fees' or 'early repayment fees'.
  - ETFs can be a fixed dollar amount (for example, $1,500), a percentage of the original loan amount (for example, 1.5 per cent) or a multiple of the standard monthly repayment (for example, 3 monthly repayments). Some lenders applied a sliding scale for ETFs over the course of the mortgage term (that is, the earlier the termination, the higher the fee).
- **Break fees**, which are charged if a fixed rate loan is terminated before its maturity.
- **Termination or discharge fees**, which are charged by a lender for discharge of the mortgage, including providing a release and updating the property owner's certificate of title.

14. The ETF ban applies to all lenders in the market, which includes:

- **the four major banks**, which account for the majority of mortgage lending;
- **other banks,** including smaller Australian banks and foreign banks;

- **mutually-owned ADIs**, which include mutual banks, credit unions and building societies; and
- **non-ADI mortgage lenders**, which are not prudentially regulated by the Australian Prudential Regulation Authority (APRA), are unable to accept deposits, and generally fund their lending activities through wholesale debt markets.

HISTORICAL CONTEXT

15. ETFs first emerged as 'deferred establishment fees'. Following their introduction, ETFs grew in level and prominence. Over the period from 1995 to 2007, ETF revenue as a proportion of overall fees in the Australian mortgage market increased from around 19 per cent to around 42 per cent (ASIC, 2008).
16. ETFs were popular among non-ADI lenders as a means to lower the up-front home loan cost to borrowers and to lower their advertised lending rates. Some borrowers benefitted from these arrangements through the trade-off between beneficial terms and fee structures and higher mortgage ETFs, as well as a more diverse range of product offerings.
17. ASIC's survey of ETFs in 2008 identified that the level of ETFs varied by lender, with non-ADIs on average charging significantly higher ETFs (see Table 1).

TABLE 1: AVERAGE VARIABLE RATE MORTGAGE FEES BEFORE ETF BAN (2008)

	Large Banks	Mutual ADIs	Non-ADIs
Total setup fee	$454	$582	$732
Service fees over 3 years	$310	$112	$216
Discharge fee	$114	$92	$230
If terminated within 3 years	$1,081	$401	$1,944
Total fees	$2,255	$1,388	$3,268

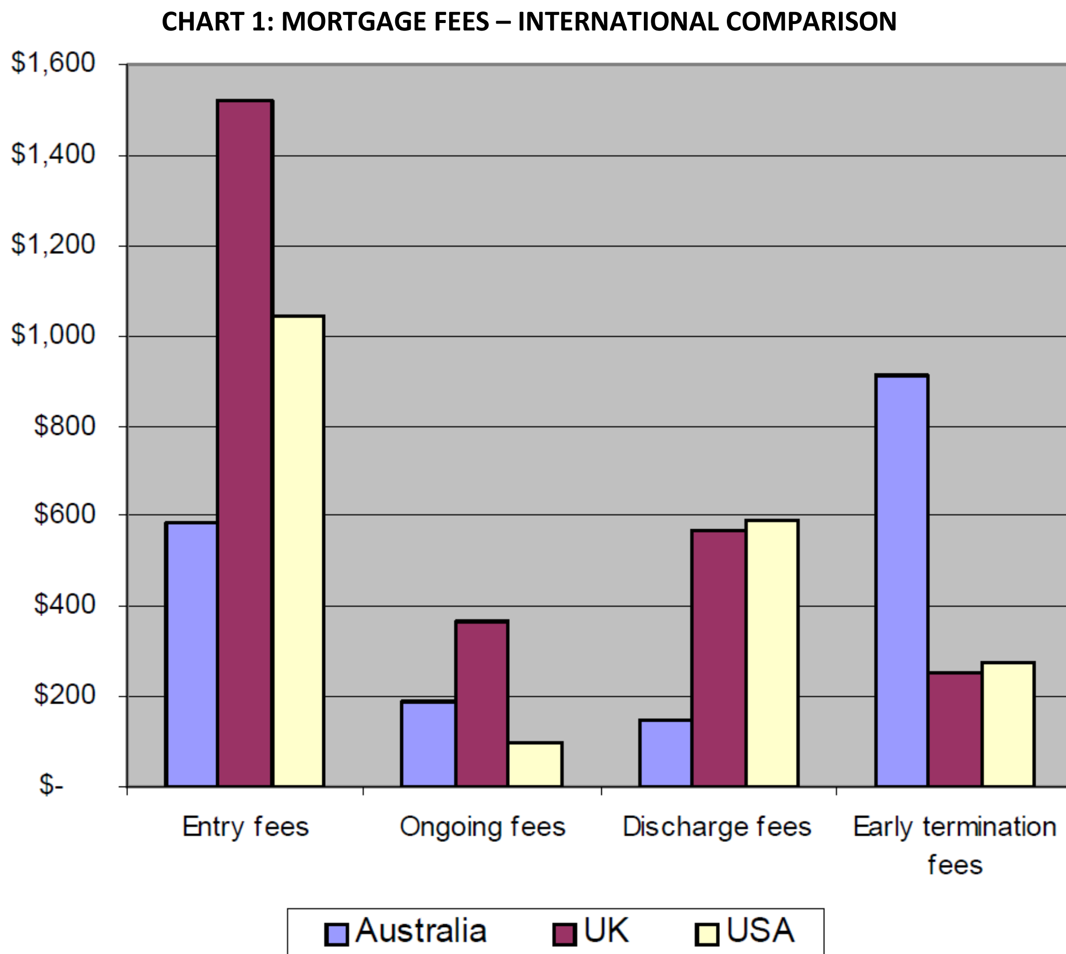
Source: ASIC (2008)

18. As illustrated by Table 1, the size of ETFs could be substantial. When added to other fees required to refinance a mortgage, such as a discharge fee, borrowers faced a significant financial barrier to switching loan products.
19. ASIC (2008) observed that 'the size of these fees might now present a barrier to switching loans during the period in which they are applicable (that is, within the first three to five years)'.

20. ASIC (2008) noted that 'As the prevalence and level of ETFs has grown, some do not appear to be related to the underlying costs they are purporting to recover', for example where ETFs were calculated as a fixed percentage of the total amount financed, or a multiple of the monthly repayment amount. ASIC's 2012 review of ETFs found that, as at February 2011, around 23 per cent of loans were subject to a fee proportionate to the loan size, rather than a fixed fee.

21. An international comparison of ETFs showed that Australian borrowers faced significantly higher ETFs relative to borrowers in the UK and USA (see Chart 1). However, other types of fees were lower in Australia.

CHART 1: MORTGAGE FEES – INTERNATIONAL COMPARISON



Source: ASIC, 2008.

22. While lenders in Australia are required to publish comparison interest rates for home loans that take fees into account, ETFs were excluded from the calculation of these. The exclusion of ETFs from the calculation of the comparison rate allowed lenders to charge high ETFs while still being able to advertise relatively low comparison interest rates. This encouraged the use of ETFs by lenders.

23. However, ASIC 2008 noted that attempting to include ETFs in comparison rates could reduce the utility of the comparison rate for borrowers, as it may lose direct relevance to a consumer's particular circumstances (that is, through the disclosure of average loan durations), particularly for those who do not switch and never incur this cost.

PREVIOUS REVIEWS & EARLIER REGULATORY ACTION

24. ETFs have been the subject of several reviews by regulators and Parliament.

25. In April 2008, ASIC's *Review of mortgage entry and exit fees (Report 125)* found that the size of ETFs may present a barrier to borrowers wanting to switch loans, through the imposition of additional costs to switching.

26. In November 2008, the House of Representatives Standing Committee on Economics published its *Inquiry into competition in the banking and non-banking sectors*. The Committee recommended that the then-Government consider mechanisms for addressing unfair entry and exit fees.

27. In 2010, the *National Consumer Credit Protection Act 2009* (the National Credit Act) commenced and amendments to the *Australian Securities and Investments Commission Act 2001* (ASIC Act) were made, replacing state-based consumer credit regulation. This legislation provides protection against unfair contract terms in consumer contracts, meaning that a fee is unconscionable if it exceeds a reasonable estimate of costs, and a court can review an unconscionable fee.

28. In November 2010, ASIC released its *Regulatory Guidance 220 (RG 220) Early termination fees for residential loans: Unconscionable fees and unfair contract terms*. RG 220 provided guidance on when ETFs may be unconscionable under the National Credit Code or unfair under the ASIC Act. It sets out the factors that ASIC would consider in deciding to take action on ETFs.

29. In May 2011, the Senate Economics References Committee report, *Competition within the Australian banking sector* noted that excessive fees on variable rate home loans had the potential to substantially weaken competition in mortgage lending. The Senate report recommended that the then-Government reconsider its decision to ban ETFs until the effect of the changes to consumer credit laws was clear. This recommendation was dissented by the then-Government Senators' minority report.

30. In September 2012, ASIC's *Review of early termination fees for residential loans entered into before 1 July 2011* found that, in accordance with the law at the time, the majority of lenders were not charging ETFs above a reasonable estimate of their losses. However, it found a small number of lenders may have been charging in excess of a reasonable estimate of their losses.

THE PROBLEM

31. The main problems associated with ETFs are:
    - ETFs can reduce borrowers' ability to refinance because they increase transaction costs.
    - ETFs can add complexity for borrowers, potentially decreasing allocative efficiency.
    - ETFs became unpopular with many borrowers after the GFC.
    - If ETFs did not truly reflect a reasonable estimate of the loss to the lender, the existing legal protections could not be engaged without significant costs being incurred.
32. However, ETFs had potential benefits in increasing the number of potential business models, and thus competition, in the mortgage market.
33. There is also a possibility that the market could have self-corrected, as seen by some lenders removing ETFs on their products in advance of the ban, although the likelihood of this spreading across the market is difficult to determine.

REDUCING BORROWERS' ABILITY TO REFINANCE

34. Competitive pressure is important in lending markets, as competition can improve the efficiency of the allocation of resources and risks in the lending market itself, as well as the broader financial system.
35. ETFs increase transaction costs for existing borrowers to switch products and thus require lenders to offer comparatively higher savings to entice a customer to refinance. This reduces competitive pressures by making borrowers less likely to switch. For example, a borrower that has entered a loan with a high ETF may not be able to take advantage of lower interest rate offered by a different lender because the savings from the lower interest rate would be erased by the cost of the ETF.
36. ETFs also create a barrier to the benefits of competitive pressures for new borrowers from flowing through to refinancing borrowers. For example, existing borrowers are often unable to access lower cost products with their current lender due to the terms and conditions attached to these products, namely that they are for new customers only. This can include situations where the interest rate reduction is structured as a discount to the standard variable rate, rather than a reduction to the standard variable rate itself (which may flow through to existing customers). If the borrower seeks to refinance with another lender, savings, as mentioned earlier, must be higher than cost of the ETF for refinancing to make financial sense. Thus, an existing borrower may have to remain in a higher-cost product than they would if they were a new borrower.
37. Competitive pressure on lenders is not imposed equally by all borrowers. For example, high-risk borrowers may not meet certain lenders' standards and conditions and therefore would have access to a smaller number of mortgage products. Thus, with or without ETFs, high-risk borrowers may have fewer options to refinance. In Australia, non-ADI lenders tend to

lend more to high-risk borrowers so the competitiveness of this submarket is more significant for high-risk borrowers.

ADDING COMPLEXITY FOR BORROWERS

38. The market provides the most efficient way to align borrowers' preferences with loan and credit products. However, where many people choose a sub-optimal product, a market failure can exist causing a loss in allocative efficiency.

39. When ETFs are used by lenders, the full cost of a mortgage is not necessarily transparent to a borrower. The borrower may not be aware of the cost of the ETF and/or is unlikely to anticipate that they will change lenders and incur the fee. This makes comparing products more difficult and thus increases the likelihood borrowers choose the wrong product.

40. Borrowers may not be aware of the impact of ETFs due to a number of reasons. Firstly, ETFs are often expressed as contingent fees that will only be incurred in unlikely circumstances and are not included in comparison rates across mortgage products (see Example 1 for further explanation). However, the average mortgage is terminated or refinanced within the first three years, when ETFs would typically apply (ASIC 2008).[1]

41. Secondly, product disclosure statements are not widely read and borrowers can find them difficult to understand.

42. Thirdly, advertising standards do not require mortgage products be described in such a way that allows borrowers to easily compare products, taking into account all potential fees. It is important to note, however, that the CSBS package introduced the requirement for a home loan fact sheet which would have provided further clarity to borrowers on ETFs had they not been banned.

43. Consumers may also face difficulty in assessing whether a lender will become less competitive over time, and hence the likelihood that they would switch and incur an ETF.

44. The additional complexity ETFs impose is compounded when taking into account the fact that borrowers may have time-inconsistent preferences (see Cameo 1 for an example). Time-inconsistent preferences cause borrowers to overweight the cost of establishment fees and introductory interest rates and underweight the cost of ETFs, causing an overvaluation of certain loan products. Thus ETFs can cause more people to choose loan products that are sub-optimal.

45. Refinancing activity is approximately 25-30 per cent under the ABS definition of 'refinancing', which excludes those moving to a new property or refinancing with the same lender (which may not incur an ETF) (ABS 2014). When combined with the short-term expectations of the average borrower, these turnover rates imply that borrowers may not understand how likely they are to incur this fee, and therefore the full cost of the mortgage product.

1 This statistic includes all refinancing events, either with the same or another lender, including increasing the loan size, changing the loan type, or moving to a new property.

EXAMPLE 1: COMPLEXITY OF THE COSTS OF BORROWING WITH AND WITHOUT ETFS

46. The following example demonstrates the complexity of calculating the costs of borrowing with ETFs compared with after the ETF ban. The example also shows the cost impact (in dollars and percentage terms) of not including the costs of breaking a variable rate loan within the comparison rate.

47. In Australia, ETFs were not included in the comparison rate because not all borrowers will break a loan. If ETFs were included, their impact would have had to have been weighted according to an agreed percentage of borrowers that break a loan. Including ETFs in a comparison rate would make it an overestimation of the cost of a loan for those who do not break a loan and an underestimation of the cost for those borrowers who do break a loan.

48. The example is based on a typical loan with a major bank in April 2011 (before the ETF ban) and April 2015 (after the ETF ban). Interest rates and fees are sourced from the websites of the major banks in 2011 and 2015. The loan is for $150,000 over 25 years, and costs are calculated for each scenario at the end of 3 years.

CHART 2: TOTAL COSTS OF BORROWING $150,000 AFTER 3 YEARS, BEFORE AND AFTER ETF BAN

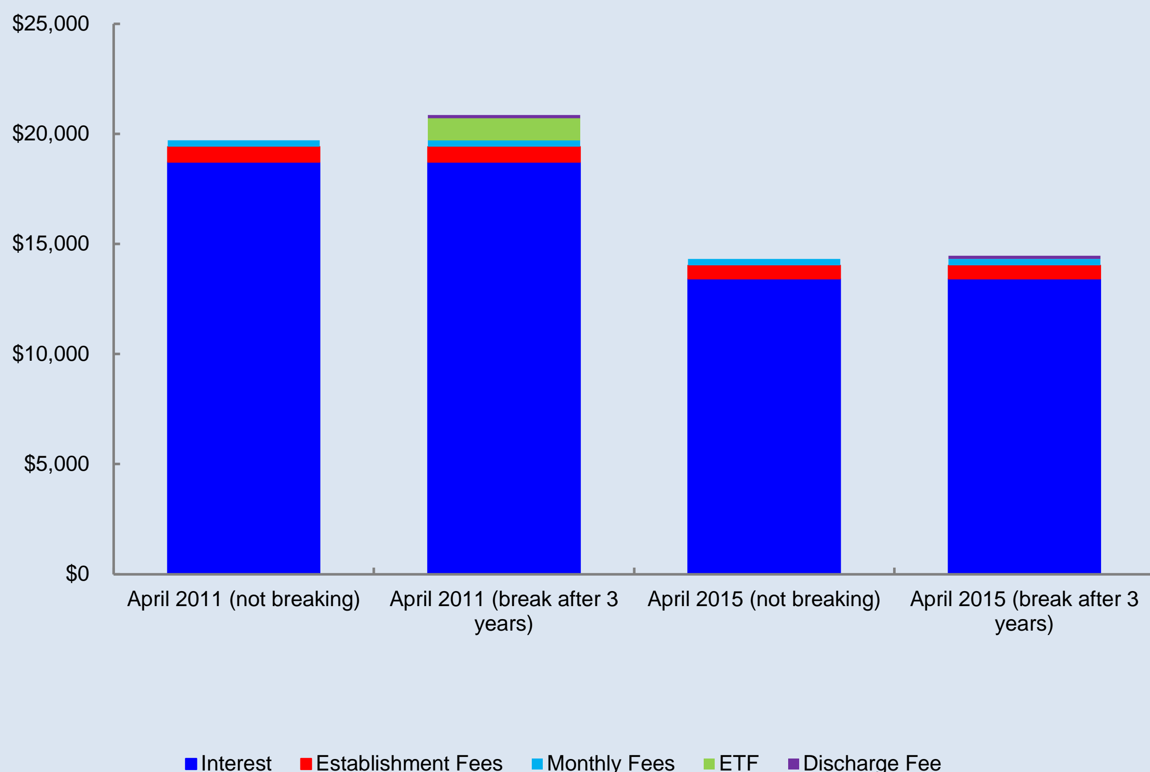


TABLE 2: COST COMPARISON OF LOAN PRODUCTS BEFORE AND AFTER ETF BAN

	Commenced April 2011		Commenced April 2015	
	No break after 3 years	Break at 3 years	No break after 3 years	Break at 3 years
Interest rate	7.80%	7.80%	5.65%	5.65%
Monthly fee	$8	$8	$8	$8
Discharge fee	N/A	$150	N/A	$150
ETF	N/A	$1000	N/A	N/A
Comparison rate $150,000 loan for 25 years plus select fees	8.20%	8.20%	6.01%	6.01%
Comparison rate - including all fees $150,000 loan for 25 years plus all fees	8.20%	8.66 %	6.01%	6.07%
Underestimation of standard comparison rate	0.00%	0.46%	0.00%	0.06%
Fees not included in comparison rate	$0	$1,150	$0	$150

49. The above example demonstrates that the borrower who commenced in April 2011 (with ETFs) faces $1,150 of costs that are not included in the comparison rate if they break the loan 3 years later. This means the comparison rate would have been effectively underestimated by 46 basis points.

50. The borrower who commenced in April 2015 (without ETFs) faces unaccounted costs of $150 to break the loan (a discharge fee), which means the comparison rate would have been effectively underestimated by 6 basis points.

51. While there are still unaccounted fees for breaking the loan in 2015, the difference between the mandated and break fee-inclusive comparison rate is substantially lower than before the ETF ban, thus reducing complexity for borrowers.

CAMEO 1: HOW ETFS CAN CAUSE BORROWERS TO CHOOSE A SUB-OPTIMAL PRODUCT

52. This cameo demonstrates how ETFs can result in borrowers choosing a sub-optimal loan product by examining the example of Sharon deciding on a home-loan product.

53. The complexity faced by Sharon is indicative of what consumers faced prior to the ETF ban, which included assessing the impact of different interest rates, honeymoon rates, establishment fees and ETFs to decide on their optimal loan product.

54. This cameo includes a product that has a honeymoon rate because, prior to the ban, honeymoon rates often went hand-in-hand with ETFs. This was because ETFs could reduce the likelihood that a borrower changed lenders, and when lenders believed that a borrower would remain a customer for longer, they were more able to offer honeymoon-period discounts.

55. While this cameo demonstrates much of the complexity faced by borrowers prior to the ban, the ETF ban did not address all of these complex elements.

TABLE 3: PRODUCT CHOICE

	Loan Product A	Loan Product B
Loan amount	$250,000	$250,000
Loan Period	30	30
Honeymoon rate for first 12 months	N/A	7.60%
Interest rate	7.80%	8.20%
Total setup fee	$700	$0
Service fees over 3 years	$200	$200
Discharge fee	$200	$200
ETF	$800	$3,500

TABLE 4: TOTAL FINANCIAL COSTS AFTER 3 YEARS (IN INTEREST AND FEES)

	Loan Product A	Loan Product B
Total cost if not breaking loan at 3 years	$59,129	$59,205
Total cost if breaking loan at 3 years	$60,129	$62,905

NB. Calculations do not adjust for time-value of money.

Decision-making based on financial cost

56. Sharon faces a choice between the above two home loan products, A and B. Based on the costs at the end of the first three years of the loan, and excluding all other factors, the optimal choice for Sharon is to take out loan product A, and to not terminate the loan at three years. If she followed this advice, it would cost her **$59,129** after three years in interest and fees. All other scenarios would cost her more (Table 4).

Decision-making including cognitive bias

57. However, Sharon, like many borrowers, has time-inconsistent preferences (in the same way as described by O'Donoghue & Rabin 1999). This means that Sharon exhibits a present-bias such that she gives greater utility-weighting to a moment as it gets closer to the present-day. As a result, Sharon may be able to assess the cost of a product that she intends to purchase in the distant-future fairly accurately. However, when the moment arrives to purchase, she will significantly overweight the near-costs and underweight the distant-costs.

58. As such, when deciding between loan product A or B, Sharon's present-bias causes her to over-weight certain components of each product while under-weighting other components. For example, she over-weights the honeymoon period interest rate of loan product B, while under-weighting the benefit of loan product A's lower interest rate over the life of the loan. She also underweights the potential $3,500 ETF of loan product B, while overweighting the $700 setup fee of loan product A.

59. Consequently, Sharon decides to take out loan product B because she believes, at the time of purchase, that it is the optimal product.

Incurring an ETF when circumstances unexpectedly change

60. If, in addition, Sharon took out loan product B with a non-ADI lender before the GFC she would likely have wanted to refinance after the GFC, causing her to incur the $3,500 ETF. This is because when the GFC occurred, interest rates at non-ADI lenders did not decrease at the same rate as other banks and thus became uncompetitive.

61. As a result, Sharon would have ultimately chosen the least-optimal product and incurred the highest possible cost of **$62,905** (Table 4).

Conclusion

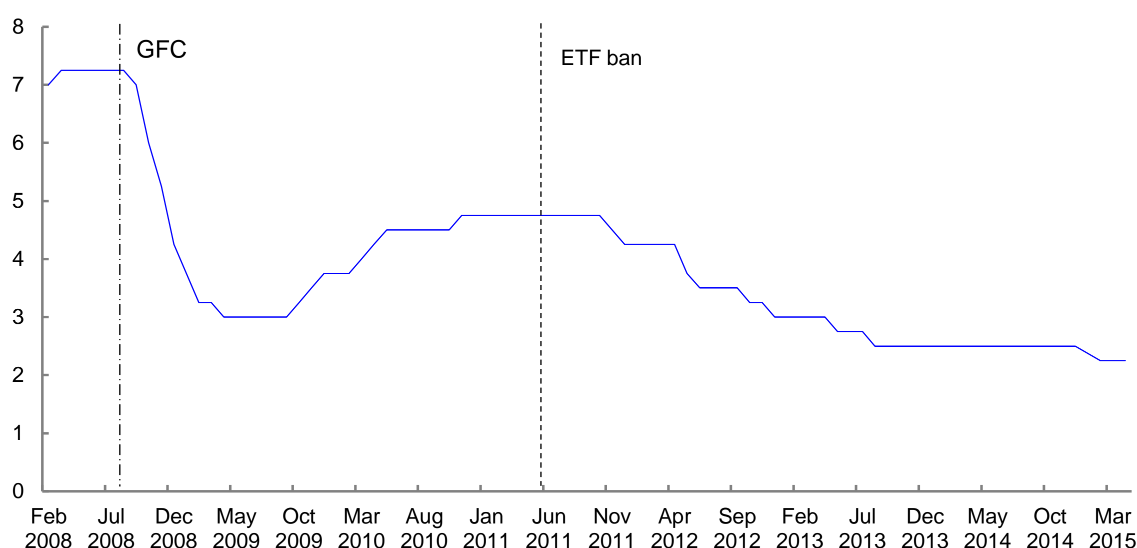
62. This cameo demonstrates how cognitive biases and the difficulties in determining the probability of incurring an ETF can result in borrowers choosing a suboptimal product.

IMPETUS FROM THE GFC

63. The GFC had a significant impact on the impetus for change in ETF regulation.

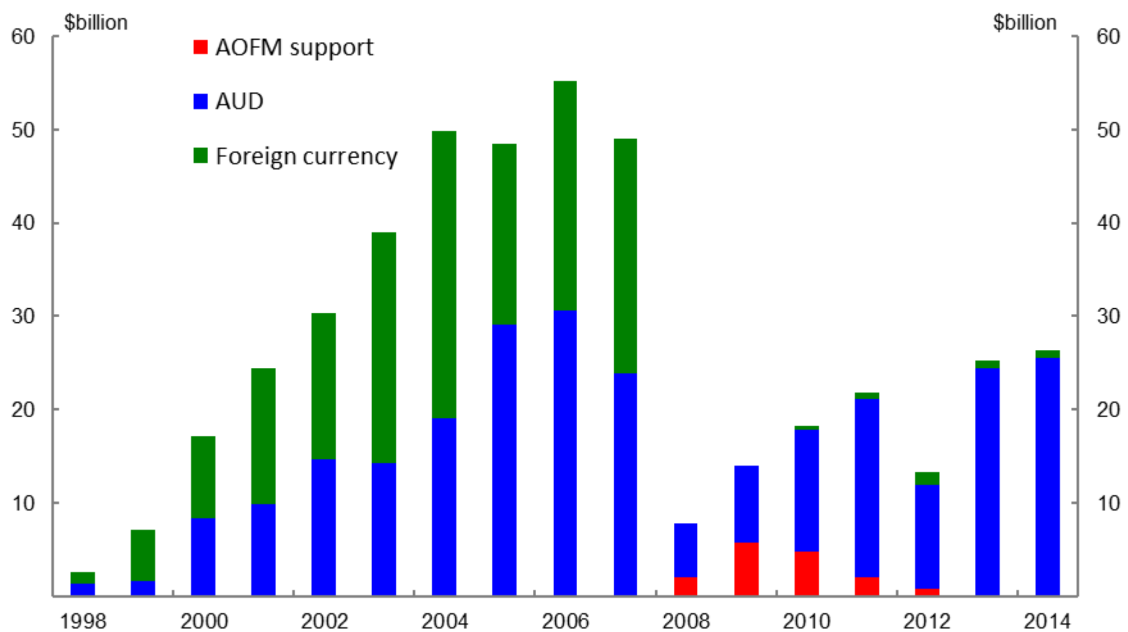
64. This was, firstly, because official interest rates fell dramatically, 400 basis points in 5 months (See Chart 3), causing many borrowers to seek to refinance. As borrowers have limited abilities to predict future financial conditions, Australian borrowers could not be expected to have foreseen the GFC. The rapid and dramatic change in funding conditions caused by the GFC meant that many borrowers changed their borrowing preferences. With rates falling rapidly, many borrowers sought to refinance fixed-rate mortgages and uncompetitive variable-rate mortgages. In the absence of such a shock, the market may have continued to accept ETFs.

CHART 3: RBA CASH RATE



65. Secondly, the GFC disrupted the business model of non-ADI lenders which caused their mortgage products to become relatively uncompetitive, resulting in many borrowers wanting to refinance with other lenders. Following the GFC, securitisation for a time became an unattractive source for funding mortgage lending, and non-ADI lenders saw their share of lending fall as increased funding costs inhibited their ability to compete on price. The collapse of securitisation as a competitive funding source over this period is seen in the dramatic fall off in residential mortgage-backed security (RMBS) issuance (see Chart 4).

CHART 4: AUSTRALIAN RMBS ISSUANCE (A$ EQUIVALENT, ANNUAL)



Source: RBA, Treasury calculations.

66. The volume of people seeking to switch and the high costs of doing so increased public awareness of ETFs. The Financial Ombudsman Service (FOS) explained in its submission to ASIC Consultation Paper 135 that through the GFC it received an unprecedented number of complaints, including 1,131 complaints regarding break fees for fixed rate loans, in the period 1 September 2008 to 31 December 2009.

67. FOS did not provide data in its submission to ASIC on the number of complaints relating to what are now characterised as ETFs. However, this increased level of complaints in relation to break fees is indicative of the interest in refinancing at the time and concerns about related costs.

BARRIERS TO LEGAL RECOURSE FOR UNCONSCIONABLE FEES

68. The potential for ETFs to be unfair and unconscionable was identified in ASIC's 2008 report. Lenders may express these fees as a contingent fee, which must only be paid if certain conditions arise. This makes the loan look less expensive than is potentially the case, as a significant proportion of borrowers may pay the fee.

69. There are two national laws relevant to ETFs which are administered by ASIC. These are the National Credit Code (the Code), which is part of the National Credit Act, and the ASIC Act, particularly the provisions prohibiting unfair contract terms (UCT) in consumer contracts. The Code and the UCT provisions commenced on 1 July 2010.

70. Given provisions in the Code and ASIC Act, ASIC could have challenged in court the validity of an ETF on the basis that it is unconscionable or unfair. Similarly, consumers could have also undertaken court proceedings over ETFs, either individually or as a class action. However, in practice, the protections offered by consumer credit protections are hard to enforce, given the complexity of determining what constitutes an unfair or unconscionable fee.

71. In order for a fee not to be unconscionable it must be a reasonable estimate of the lender's loss. However, ASIC found that some lenders themselves were unable to precisely estimate their loss (ASIC 2012).

72. The submission of the Consumer Credit Legal Centre NSW to this review raised further doubts about the effectiveness of existing consumer credit law protections in eliminating excessive fees, due to the inability of the external dispute resolution mechanism to handle the complexity of 'unconscionability'.

73. As noted, ETFs in consumer contracts were also subject to the unfair contract terms provisions in the ASIC Act, which makes a term in a standard form consumer contract void if it is unfair. However, as the law was only introduced in 2010, there was no clear precedent as to what constitutes an unfair contract term in relation to ETFs.

74. In addition to issues around complexity, the costs required to proceed with legal recourse may act as a barrier to legal action being commenced. Legal proceedings can also take a number of years; for example, the class action against ANZ on penalty fees, which similarly relates to unconscionability, commenced in 2010 and was still subject to appeals in 2015. These potentially extended timeframes meant that the problem of excessive ETFs preventing consumers from refinancing are unlikely to be addressed via court action in a timely manner.

75. The combined effect of the complexity of determining what is an unfair or unconscionable fee and the cost and time involved means that borrowers may struggle to obtain relief from excessive ETFs under consumer law.

76. An ASIC review of its regulatory guidance on ETFs (ASIC 2012) found that, for mortgage loans subject to the changes in consumer credit laws, less than one per cent of instances where an ETF was paid resulted in a customer complaint. However, more than half of those complaints resulted in the ETF being waived or reduced (ASIC 2012). This suggests that while existing consumer credit protections may have reduced the incidence of excessive fees, they had not been eliminated altogether.

POTENTIAL BENEFITS OF ETFS

77. An alternative measure of competition to the level of refinancing is the number of market participants. In this regard, ETFs could be seen to increase competition because they allow for more business models and thus more market participants. For example, smaller banks, with higher costs of funding, could offer competitive interest rates to attract borrowers while taking advantage of high ETFs to offset their higher funding costs. This would provide overall benefits for borrowers who access these loans, particularly where they do not refinance their loan within the ETF period.

POTENTIAL FOR MARKET SELF-CORRECTION

78. Given the media attention on ETFs and growing expression of consumer preference for a product without ETFs (for example, SMH 2009) there is a question as to whether regulation was necessary or if the market was likely to correct automatically.

79. By the time the ETF ban was applied in Australia many financial institutions, including some of the major mortgage lenders, had already ceased charging ETFs. Two major banks, ANZ and NAB, which collectively made up around 30 per cent of the bank mortgage lending market at the time of the ban, had stopped charging early termination fees in November and December 2010, respectively. This may indicate that the market was self-correcting in response to growing evidence of changing consumer preferences.

80. However, the then-Government announced its intention to ban exit fees in December 2010. It is possible that these lenders moved in anticipation of a change in government policy. Other lenders abolishing ETFs between December 2010 and June 2011 may also have reflected lenders seeking to adjust their business models before the regulations came into effect.

81. Given the close timing of lenders beginning to abolish ETFs and the then-Government's announcement, it is not possible to determine whether this change in market practice was evidence of self-correction or of lenders seeking to gain first-mover advantage. It is also not possible to determine whether any self-correction would have been temporary or ongoing.

OBJECTIVE OF GOVERNMENT ACTION

82. The ban on ETFs was one component of the previous Government's CSBS reforms announced in December 2010.

83. The previous Government's objectives were to enhance transparency and flexibility in the Australian mortgage market by making it easier for borrowers to enforce competitive discipline. In an announcement in December 2010, the previous Government noted:

> *'The Gillard Government has been concerned for some time that some banks are using mortgage exit fees to lock customers into their home loans. Exit fees can be so high that they completely wipe out the savings from switching to a cheaper mortgage with another lender.'*
>
> **Competitive and Sustainable Banking Announcement**

OPTIONS CONSIDERED

84. When the decision was made, two main options were considered:

- Option 1: No change and continue to respond to ETFs through ASIC enforcement of UCT legislation and issuance of regulatory guidance.

- Option 2: A ban on ETFs.

85. The inclusion of ETFs in the standardised comparison interest rate was considered by ASIC (2008) to be impractical and likely to reduce the utility for borrowers of such a comparison rate.

IMPACT ANALYSIS

86. The ETF ban is assessed with regard to borrowers, lenders and competition.

BORROWERS

IMPROVEMENT IN TRANSPARENCY AND ALLOCATIVE EFFICIENCY

87. The lack of ETFs allows borrowers to more easily compare complex financial products, thus one would expect more borrowers to choose the right financial product for their preferences.

88. In its submission, CHOICE notes that borrowers have benefitted from the transparency associated with clearer and more upfront fee structures, stating that:

> *'while there may have been some shifting from 'exit' to 'entrance' fees, this is – while not desirable for consumers – preferable to a situation where such fees continue to remain non-transparent and largely hidden, making it difficult to compare products up-front on their relative merits.'*
>
> **CHOICE submission to Treasury**

89. While the increased transparency from the ETF ban would be expected to increase allocative efficiency, and one submitter supported this, there is not sufficient evidence to conclude that this occurred.

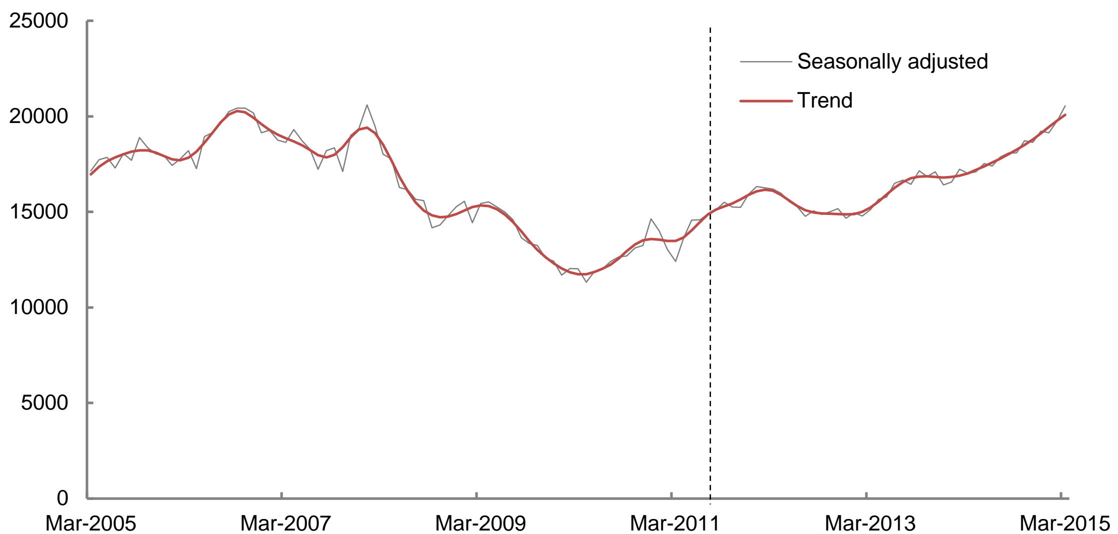
INCREASED ABILITY TO REFINANCE

90. Without ETFs, transaction costs are lower for existing borrowers to switch products. This should benefit consumers with loans that become uncompetitive, who are more easily able to switch or use the threat of switching to negotiate a discounted rate with their existing lender. This increased flexibility should be evident in the volume of refinancing.

91. Chart 5 shows the increase in refinancing of established dwellings with a new lender following the prohibition. According to ABS data, the six-monthly rolling sum of national refinancing of established dwellings rose from 80,324 in June 2011 to a post-GFC high of 113,591 in December 2014. This data is likely to understate the actual level of mortgage refinancing as it excludes instances where borrowers refinance with the same lender, for example for a lower or discounted interest rate.

92. However, this trend increase in refinancing was evident prior to the ETF ban, commencing in 2010 following the GFC.

CHART 5: REFINANCING OF ESTABLISHED DWELLINGS (NUMBER)



Source: ABS catalogue no. 5609.0

93. In contrast to the ABS data, the AFG noted in its submission that discharge rates for loan books have remained relatively constant since the ETF ban. Similarly, the Australian Bankers' Association (ABA) noted that '*there does not appear to have been a decrease in the average life of a loan on banks' books*'.

94. CHOICE submitted to this review that the ETF ban '*has achieved its primary objectives of increasing the mobility of Australian consumers in the mortgage market and improving transparency in products*'.

95. The aggregate effect of the ETF ban on refinancing is not clear. While submissions from AFG and ABA contend that refinancing has not increased, the submission from CHOICE and data from the ABS suggest that refinancing has increased since the ETF ban. However, the trend observed in the data began after the GFC and thus it is not clear what effect the ETF ban had in isolation. The significant decrease in interest rates, or a combination of other factors, could be causes of the increase in refinancing activity observed.

ALTERNATIVE FEES

96. The ban on ETFs could have been expected to lead to increases in alternative fees for borrowers, as lenders looked to recoup their fee income in another form.

97. A discussion of the evidence around alternative fees is presented under the 'lenders' section. The data suggests that lenders have not sought to recoup ETFs by introducing or increasing other mortgage fees.

REDUCTION IN CHOICE OF HOME LOAN PRODUCTS

98. ETFs increased the certainty of revenue to lenders over the term of the loan, enabling them to offer products with a lower interest rate during the introductory 'honeymoon' period of the

loan. Thus after the ETF ban, one could expect the prevalence of honeymoon rates to decrease.

99. The Mortgage & Finance Association of Australia (MFAA) submission noted that following the ETF ban there has been a large reduction in the number of mortgage products offering 'honeymoon' interest rates.

100. A reduction in choice of home loan products would have had an adverse effect on borrowers suited to those products, such as those who did not choose to switch mortgages.

AGGREGATE EFFECTS ON BORROWERS

101. The aggregate effect of the ETF ban could be said to be positive for many borrowers; however, some borrowers may also have been made worse off.

102. Indicators of positive effects on borrowers are: the increase in transparency; data that show that refinancing has increased after the ban, suggesting that borrowers have benefitted from increased flexibility; and data that suggests that lenders have not sought to recoup lost ETFs by increasing other mortgage fees.

103. However, this comes with the caveat that the increase in refinancing activity is difficult to disaggregate from effects of the GFC.

104. The case for negative effects on borrowers is that for those borrowers for whom ETFs were of benefit, for example those who were benefitting from honeymoon rates and would not have changed mortgages, the ban on ETFs would have had a negative effect by reducing the availability of these products.

LENDERS

COMPLIANCE COSTS ON LENDERS

105. Submissions from lenders indicated that the prohibition of ETFs imposed compliance costs on them.

106. To calculate the costs associated with the ban, Treasury sought feedback from lenders. Confidential information from lenders suggested the most substantive compliance costs are:

- one-off costs, which includes updating standard terms in contracts;
- updating documentation; and
- developing new cost calculation methods.

107. The compliance costs were calculated under the following assumptions:

- Given the above costs relate to implementing the ban, it is assumed that they are all one-off compliance costs.
- The number of affected entities was equal to the number of ADIs (from APRA's quarterly ADI performance statistics) and the number of non-ADI mortgage providers, which is based on a submission from the MFAA.

- This is calculated at 194 entities.

- Each of the three listed tasks above takes on average 20 hours each for each affected entity, as provided in a confidential submission.
  - This sums to a total assumed time required for compliance of 60 hours per affected entity.
- The hourly rate is calculated for an average salary with a provision for additional non-labour costs.
  - The assumed wage is $37.40 per hour multiplied by 1.75 for non-labour costs (based on the Office of Best Practice Regulation's Regulatory Burden Measurement Framework Guidance Note).

108. Under these assumptions, the total compliance cost for each lender is calculated to be $3,927.

109. The total compliance cost on lenders is calculated to be approximately $761,838 ($3,927 x 194 entities).

110. As per the formal guidance on costings in PIRs, this equates to an average of $76,184 per year over 10 years (Table 5).

TABLE 5: REGULATORY BURDEN AND COMPLIANCE COSTS

Average annual regulatory costs (from business as usual) over 10 years				
Change in costs ($million)	**Business**	**Community Organisations**	**Individuals**	**Total change in cost**
Total	$76,184	N/A	N/A	$76,184
Cost offset ($ million)	**Business**	**Community organisations**	**Individuals**	**Total, by source**
Total	N/A	N/A	N/A	N/A
Are all new costs offset? ☐ Yes, costs are offset ☑ No, costs are not offset ☐ Deregulatory – no offsets required				
Total (Change in costs — Cost offset) ($million) = $76,184.				

111. The compliance costs do not take into account costs that are difficult to quantify. For example, an ongoing cost is the time required for lenders to deal with complaints from borrowers who thought the ban was retrospective, and thus applied to their mortgage, and for borrowers who thought the ban applied to break fees on fixed rate mortgages. Lenders did not provide data on how many of these inquiries they have received, and how long each takes to address. However it is likely that these costs will decrease over time as more mortgage contracts are captured by the ban.

112. Mortgage brokers also noted added compliance costs from handling increased complaints from borrowers who did not understand the scope of the ban, stating that:

> *'Many consumers do not have clarity on the nature of the exit fees banned in this reform and the contracts that this applies to. Consumers that hold mortgage contracts in place before 1 July 2011 are not normally aware that the reform put in place applies to contracts post 1 July 2011.'*
>
> *'The introduction of the reform has increased compliance costs for the management of complaints by consumers on all costs that may be applied to a discharge of a residential loan.'*
>
> **AFG submission**

113. As a result, in addition to the cost of approximately $76,180 on average per year over 10 years, lenders would have also incurred the unquantified cost of increased complaints.

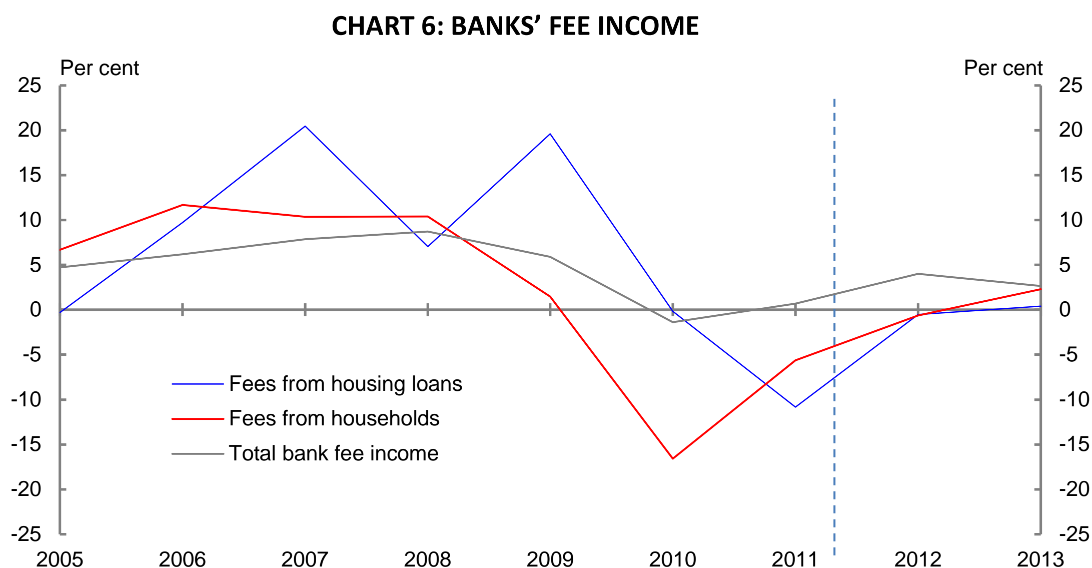
IMPACT ON FEE INCOME

114. The prohibition on ETFs would be expected to reduce the fee income of banks, mutuals, non-bank lenders and brokers. While fee data is not available for all of these lenders, ADI fee data provides an indication of the effect of the ETF ban.

Total fee income

115. Prior to the GFC, banks' fee income had been growing at or above 5 per cent per annum. After falling in 2010, total fee income has returned to growth, despite the introduction of the ban on ETFs (see Chart 6).

CHART 6: BANKS' FEE INCOME



Source: RBA 2015 (Domestic Banking Fee Income - C9), Treasury calculations

116. Submissions provided anecdotal evidence of some mortgage brokers being affected by lenders seeking to recoup the revenue lost from the ETF ban through clawbacks of broker commissions. This may have been partially offset by an increase in brokerage business as

borrowers refinanced their loans more often. No data is available, or was provided, to quantify the lender-wide cost of these impacts.

117. Submissions noted that mutual ADIs have not been heavily affected by the potential decline in fee revenue, as they traditionally did not charge high ETFs and in many cases charged none at all.

Total fee income on housing loans

118. The RBA found that the ETF ban initially contributed to a reduction in overall home loan fees paid by borrowers to banks:

> *'Total fee income 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 home 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 fall in exit fees charged by banks for the early termination of variable-rate mortgages.'*
> **RBA 2012**

119. Banks' housing lending fee income continued to remain flat in 2012 and 2013, suggesting that the ban has not continued to reduce banks' fee income from mortgage products. However, based on the data to 2013, growth in housing lending fee income has also not recovered to its pre-GFC rates.

120. The RBA suggests that lenders by and large have not compensated themselves for the loss of fee income by reintroducing front-ended establishment fees, or increasing mortgage fees elsewhere:

> *'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.'*
> **RBA 2013**

Banks' total fee income on household products

121. Total fee income from all household products[2] declined 7.0 and 0.3 per cent in 2011 and 2012 respectively then increased 2.3 per cent in 2013 (RBA 2013 and RBA 2014).

122. According to the RBA (2014), the increase in 2013 was predominantly driven by growth in fees from personal loans and credit cards, which reflected higher volumes in these categories, rather than any direct attempt by lenders to compensate themselves for the ban on ETFs.

2 This includes fee income from credit cards, personal loans, housing loans and deposits, as well as other household related fee income.

Aggregate effect on fee income

123. After the ETF ban, fee income from housing lending and total household lending decreased across lenders. Evidence from the RBA (referred to above) indicates that lenders did not seek to recover the lost ETF fees by increasing other mortgage fees. It is possible that lenders have instead sought to charge relatively higher interest rates. However, as discussed under 'Net Interest Margins', the major banks' net interest margins have declined since the introduction of the ban on ETFs.

124. Despite relatively flat housing and household lending fee income, banks' total fee income continued to increase, although at a slower rate immediately following the ETF ban.

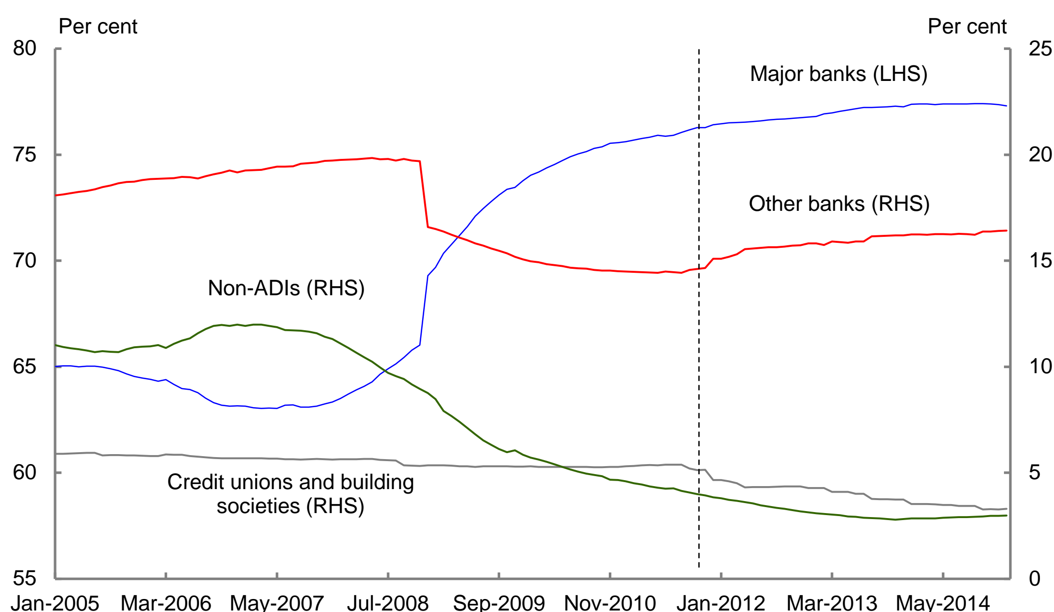
125. Given differences in product offerings, the impact of the ETF ban on non-ADI lenders' fee income may have been different to that of banks. However, data is not available to analyse the impact on these lenders.

IMPACT ON NON-ADI LENDERS

126. Non-ADIs made greater use of ETFs prior to 1 July 2011 in order to offer more competitive interest rates. Therefore, one could expect that non-ADIs' would be more adversely impacted and their market share would decline after the ETF ban.

127. Chart 7 shows that the non-ADIs' market share decreased following the ban on ETFs. However, this continued a trend evident since the GFC. As discussed previously in 'Impetus from the GFC', the business model of non-ADI lenders had been under pressure following the GFC as a result of the disruption to the securitisation market, which was their main funding channel. While it is not possible to separate out the impacts of the GFC and the ETF ban, given the existing trend it is likely that the disruption to non-ADI lenders' funding channel had a much greater impact on their competitiveness than the ban on ETFs.

CHART 7: MARKET SHARES OF MORTGAGE LENDING



Source: RBA.

128. Submissions to this review from the MFAA, Yellow Brick Road (YBR), Australian Finance Group (AFG) and the Australian Securitisation Forum (ASF) stated that the prohibition on ETFs had reduced competition in mortgage lending by making it harder for smaller lenders to compete with the larger banks.

> *'An ETF structure or deferred exit fee enables smaller lenders to offer competitive priced products to consumers. The banning of these fees reduces their ability to compete with major lenders and therefore reducing the market share of non-bank lenders in the market and ultimately competition.'*
> **AFG submission**

> *'A ban on exit fees has reduced competition by making it harder for non-balance sheet lenders to compete.'*
> **MFAA submission**

129. Contrastingly, the submission from CHOICE stated that the prohibition had helped increase competition.

> *'CHOICE would emphasise that the ban on mortgage exit fees was not intended specifically to encourage switching away from major-lenders to smaller institutions… However, we would note that the data referenced here suggests that there has not been a decline in the competitive position on non-major lenders following the introduction of the ban, as was forecast by some in the industry.'*
> **CHOICE submission**

130. Chart 7 shows that while the major banks have continued to increase their share of outstanding mortgage lending since ETFs were banned on 1 July 2011, this has not come at the expense of smaller Australian ADIs. Smaller ADIs, including non-major Australian banks, mutual banks, credit unions and building societies, maintained their combined share of outstanding mortgage loans at around 20 per cent from July 2011 to June 2014.

131. After the ETF ban, non-ADI lenders who made greater use of ETFs have experienced a decrease in market share which is consistent with the expected impact of the ban. However, the reduction in non-ADI lenders' market share began after the GFC which had major impacts in their source of funds. Thus, the disaggregated effect of the ETF ban on non-ADIs' competitiveness is not clear.

OTHER AFFECTED LENDERS

132. HomeStart Finance, a South Australian Government entity established to assist in affordable housing, noted in its submission that it was required to seek an ASIC exemption (ASIC has general powers to grant relief from the consumer credit law) to avoid the prohibition applying to its loan products, including in circumstances where HomeStart collaborates with third parties. HomeStart Finance stated that it considers '*the need to obtain an exemption from ASIC for ongoing arrangements with third parties to be an unwarranted compliance burden*'.

133. However, the exemption is only required once for each third party that HomeStart Finance collaborates with. As such, the majority of the compliance burden on HomeStart Finance has already been borne.

AGGREGATE EFFECTS ON LENDERS

134. The aggregate effect on lenders appears to be mixed. Treasury has calculated that the ETF ban caused a compliance cost of approximately $76,180 on average per year over 10 years across lenders plus the unquantified cost of an increase in queries and complaints to lenders.

135. Since the ban, major banks have taken a larger share of the market at the expense of non-ADI lenders, although this reflected a trend that commenced after the GFC.

136. ADIs' fee income from housing lending and all household lending declined immediately following the ETF ban, and remains relatively flat through to 2013. However, total fee income for the banks continues to grow, suggesting fee income is coming from other non-household-lending products. However, data is not available to determine how non-ADIs' fee income has been affected.

COMPETITION

DISCOUNTING ON LOAN STANDARD VARIABLE RATES

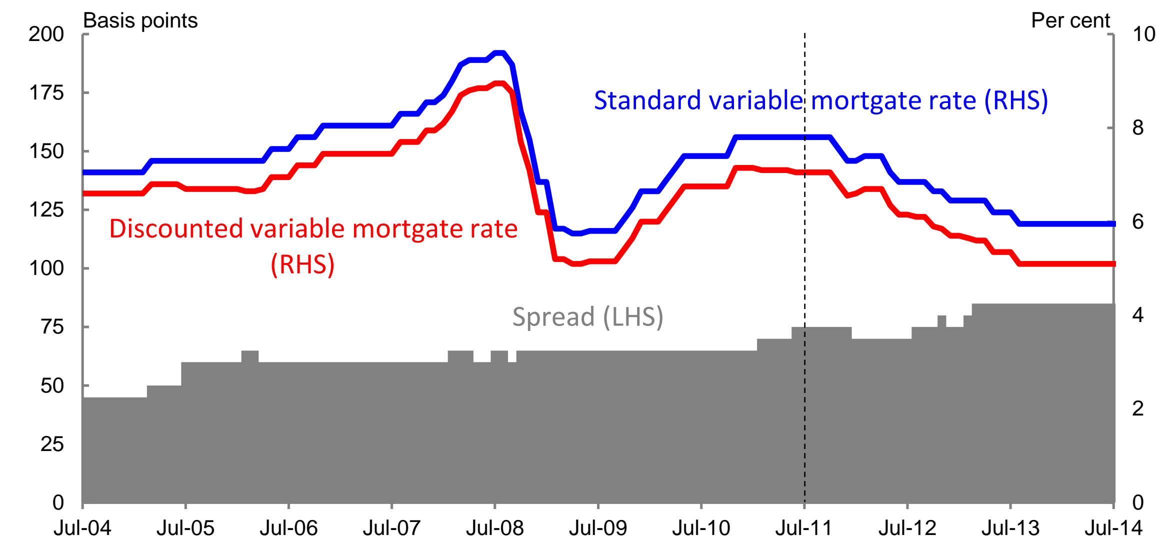
137. Discounting activity on a loan's offered interest rate by lenders is a measure of competition amongst mortgage lenders. Following the introduction of the prohibition on ETFs, lenders increased the size of discounts they offer on their standard variable rates from 75 to 85 basis points over 2 years (Chart 8). This occurred during a period of falling headline interest rates.

138. Chart 8 shows the difference between lenders' standard variable mortgage rates and discounted mortgage interest rates. While discounting behaviour will be subject to a number of influences, the upward trend in discounting from 1 July 2011 illustrates the increased level of discounting since the ETF ban was introduced. This is relative to a flat trend in discounting from 2008 through to 2010.

139. The increase in the size of discounts offered by lenders could indicate competition in the mortgage market has improved. However, it is difficult to isolate the effect the ETF ban may have on this increase as opposed to other factors driving competition in mortgage lending.

140. This could include other measures announced as part of the CSBS package such as prohibitions on anti-competitive price signalling and a mandatory one-page key fact sheet to help borrowers compare home loans.

CHART 8: SPREADS BETWEEN BANK STANDARD AND DISCOUNTED VARIABLE RATES



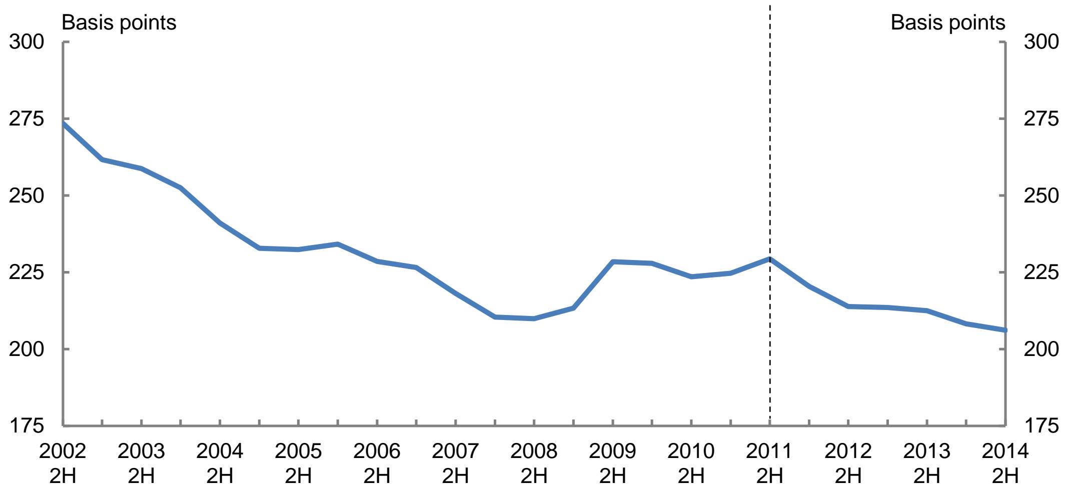
Source: RBA.

NET INTEREST MARGINS

141. Net interest margins measure the difference between banks' wholesale borrowing and retail lending rates. In times of increased competition one would expect net interest margins to decline.

142. A decline in net interest margins can be observed from after the ETFs ban (Chart 9) suggesting an increase in competitive pressures. However, it is difficult to isolate the effect of the ban on ETFs from other changes in the market.

CHART 9: MAJOR BANKS' NET INTEREST MARGINS



Source: Banks' financial reports.

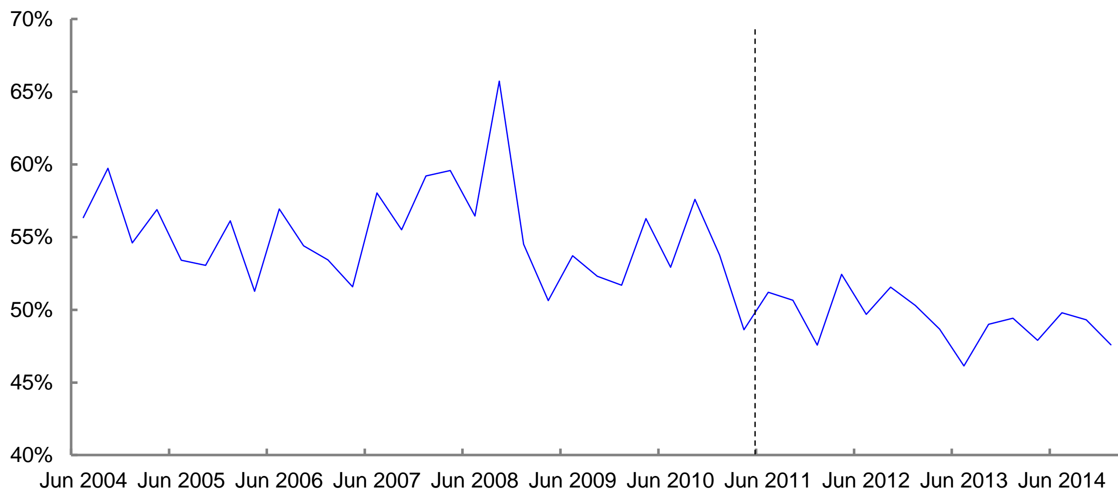
COST TO INCOME RATIO

143. Cost to income is a measure of operational efficiency. Increased competitive pressures tend to encourage banks to improve efficiencies to maintain or increase their market share.

144. ADIs' cost to income ratios have decreased since the ETF ban, suggesting an increase in competition. However, cost to income ratios had already shifted lower following the GFC,

therefore it is difficult to disaggregate the effects of the ETF ban on competition from other post-GFC factors.

CHART 10: ADI COST TO INCOME RATIOS



Source: APRA.

MARKET CONCENTRATION

145. Market concentration is often cited as a key indicator of competition. However, concentration is not necessarily an appropriate measure of competition. For example, concentration may be a result of intense competition, with a small number of highly efficient firms pushing other less efficient firms out of business.

146. The major banks have increased their market share since the introduction of the ban on mortgage ETFs, largely at the expense of non-ADI lenders, indicating an increase in mortgage market concentration.

147. As noted in the 'Impact on non-ADI lenders' section, this trend was largely a result of turmoil in securitisation markets during the financial crisis. From the late 1990s, the relative costs of securitisation fell, allowing smaller lenders to compete in mortgage markets with less reliance on balance sheets or capital bases to fund their loans. The cost of securitisation increased markedly during the financial crisis, leading to the exit of many non-bank lenders and the removal of an important source of competition.

148. As such, changes in market concentration are likely to have been driven by changes in wider economic factors rather than the introduction of the ban on ETFs.

AGGREGATE EFFECTS ON COMPETITION

149. Following the ETF ban, some indicators of competition in the banking sector have improved: spreads between bank standard and discounted variable rates have increased; major banks' net interest margins have declined; and cost to income ratios have declined.

150. On the other hand, market concentration has increased, indicating that competition may have been adversely affected through a reduced number of competitors.

151. For both the positive and negative competition indicators, it is not possible to disaggregate the specific impacts of the ban on ETFs from other factors that may have affected competition in the housing lending market, including the impacts of the GFC on non-ADIs' funding, low interest rates and regulatory developments.

CONCLUSION

152. The most apparent effects of the ETF ban are the benefits to many borrowers. Greater transparency in loan products has decreased the likelihood of borrowers choosing sub-optimal products. Additionally, decreased transaction costs have provided borrowers greater access to savings through refinancing. This is to some extent supported by the rebound in refinancing rates since the ban, although other market factors may also have had an effect.

153. Switching, or the ability to switch, loans may also increase the ability of borrowers to exert competitive discipline on lenders on an ongoing basis. This may be one reason why it appears that lenders have not sought to recoup lost ETF fees through increasing other mortgage fees.

154. Some borrowers would have been disadvantaged by the ban, through reduced product choice, particularly from non-ADI lenders. These borrowers benefitted from ETFs where they were able to take advantage of lower up-front fees and interest rates and did not incur an ETF by switching loans.

155. Many of the other identified effects of the ETF ban are difficult to isolate from other market forces. This is most evident in terms of the effects on lenders and on competition.

156. In regards to lenders, major banks have increased market share since the ETF ban, at the expense of non-ADI lenders. However, it is likely that the major cause has been the effects of the GFC on non-ADI lenders' business models, rather than the ETF ban. Fee income from housing loans fell substantially in 2011 and growth has remained flat since. Total fee income has continued to grow, however, changes in fee income are difficult to disaggregate from the changes in the volume of mortgage products sold. Furthermore, data is not available to differentiate the impact on fees for ADIs and non-ADIs.

157. Lenders faced compliance costs as a result of the ETF ban. Quantifiable costs have been estimated at $76,180 on average per year over 10 years. Lenders and brokers faced other, unquantifiable costs in responding to complaints from borrowers who misunderstood the application of the ETF ban, however, these are likely to have been minor and to have fallen over time as a greater proportion of loans become subject to the ban.

158. With respect to competition, refinancing activity, loan discounting and bank fee data are consistent with a period of sustained competition in the mortgage market in the years since the ETF ban was introduced. Even so, it is not possible to disaggregate what (if any) impact the ETF ban had on these indicators of competition compared to other market or regulatory forces.

159. The ETF ban has addressed the problems identified at the time of its introduction of: reducing the ability of borrowers to refinance their loans; complexity for borrowers; borrowers concerns about the barriers and costs of switching in an environment of rapidly falling interest rates; and the barriers to borrowers being able to effectively challenge potentially unfair or unconscionable ETFs. The ban has also addressed the objectives set by the then-Government of improving transparency and flexibility.

160. While additional ASIC guidance or enforcement may also have addressed unfair and unconscionable ETFs, the complexity, costs and time required to pursue legal recourse may have limited this approach's effectiveness.

161. Some lenders removed ETFs before the ban, indicating that the market may have eventually self-corrected without government intervention. However, given the timing involved, initial moves by lenders to abolish ETFs could have been either, or a combination of, self-correction and first mover's advantage. Furthermore, it is not certain that other lenders would have followed suit, nor whether ETFs would have eventually re-emerged, particularly as interest rates stabilised.

162. While noting the positive and negative impacts of the ETF ban and the difficulty of isolating its impacts from other factors affecting the mortgage market, it is likely that the ban has delivered a net benefit to the community through increased transparency and flexibility for consumers. This may have improved consumers ability to exert competitive pressure on lenders. Retention of the ETF ban is therefore likely to remain appropriate.

CONSULTATION

163. Primary stakeholders affected by the ETF ban include:

- borrowers;
- ADI mortgage lenders;
- non-ADI mortgage lenders; and
- mortgage brokers.

164. Consultation was conducted for this review through submissions and stakeholder meetings with representatives for borrowers, ADI and non-ADI lenders and mortgage brokers, as well as consultation through the Financial Sector Advisory Council (FSAC). Ten submissions were received in total, from the following groups:

- Australian Bankers' Association;
- Australian Finance Group;
- Australian Securitisation Forum;
- CHOICE;
- Consumer Action Law Centre;
- Consumer Credit Legal Centre NSW;
- Customer Owned Banking Association;
- Homestart Finance;
- Mortgage & Finance Association of Australia; and
- Yellow Brick Road.

165. In summary, the views from submissions and stakeholder meetings were:

- consumer advocates were positive about the impact of the reform, noting a positive impact on competition and greater protection for borrowers from excessive fees;
- some bank lenders noted increased limitations on a customer's product choice and the increased market presence of the major banks;
- some non-bank ADI lenders noted difficulty competing with the major banks;
- the mutual banking sector noted minimal impact;
- non-ADI lenders and mortgage brokers advocated removing the ban, or limiting it to only apply to ADI lenders. Non-ADI lenders cited difficulties competing with the major banks and questioned the impact on competition in the market; and

- brokers noted added compliance costs from handling increased complaints from borrowers who did not understand the scope of the ban.

166. The views from FSAC were similar:

- members agreed that the effect of the ban on ETFs on competition is not clear;
- there was a general consensus that the ban had an overall positive impact on borrowers, although some members noted that borrowers no longer had the option to avoid an establishment fee by opting for an ETF instead;
- members noted that brokers had ended up wearing the cost of the ETFs, where lenders have recovered establishment costs by 'clawing back' commissions from the broker, rather than passing them on to borrowers; and
- members also noted that there were less restrictive ways of dealing with the issues around ETFs, including ensuring borrowers were informed of ETFs and ensuring the onus of proving the that fees were cost recovery were on the lender.

167. Treasury consulted with a wide range of stakeholders on elements of the 2010 CSBS reforms, including the prohibition on mortgage ETFs. This included discussions with stakeholders and regulators on the implementation of the reforms.

168. A number of alternative consultation processes have been drawn upon for this post-implementation review. They are:

- ASIC industry consultations on mortgage fees, Report 125: Review of mortgage entry and exit fees (2008) and Report 300: Review of early termination fees for residential loans entered into before 1 July 2011 (2012);
- the House of Representatives inquiry into *Competition in the banking and non-banking sectors* (November 2008); and
- the Senate Economics Reference Committee inquiries *Competition within the Australian banking sector* (May 2011); and *The post-GFC banking sector* (November 2012).

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