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Inquiry into competition within the banking sector

Senate Economics References Committee

Submission by ProSolution Private Clients

We acknowledge that arguably one of the biggest inhibitors to increased competition is the ability for lenders, other than the Big Four, to access a competitively-priced source of funding. However, we would also argue that the main inhibitor to competition is borrowers perceived 'hassle and risk' with refinancing a mortgage loan from one provider to another. To offset this perceived 'hassle and risk', any projected interest and fee saving needs to be significant to entice a borrower to refinance away from the Big Four (for example). Therefore, concentrating on solving the 'cost of funding' issue alone will not have a significant impact on competition (unless smaller lenders have access to a materially cheaper source of funding).

The real issue

When borrowers considering switching mortgage providers they nearly always have the following three concerns:

1. <u>Time and hassle</u>: This mainly relates to the process of lodging an application with a new lender and switching all banking (and direct debits, payroll details and so on) once the refinance has gone through. Depending on the complexity of your financial life, this can be a significant deterrent to switching lenders.
2. <u>Fear of the unknown</u>: If you've been with your lender for a period of time its likely you've got to know the ins and outs pretty well (good and bad). You're familiar with their internet and phone banking. You know where the branches and ATMs are located. Everything's set up the way you want it. What if you move to a new lender and find out that it's a lot more difficult to get things done or the products don't work like you would expect? Sometimes it's better to deal with the devil you know.
3. <u>Cost</u>: The two determinants of cost are the competitiveness of other bank products versus the cost of your existing lender and the exit costs.

Any potential cost saving (i.e. item # 3 above) needs to outweigh the potential cost and risk associated with items 1 and 2 above for a person to switch lenders. For most people, they would need to be convinced that the dollar saving will be very significant to offset any potential non-financial negatives. In the early 1990's Aussie Home Loans was able to offer interest rates approximately 1% lower than the majors which created a lot of competition. In the absence of a pricing differential of this magnitude, most borrowers will opt to 'do nothing' and stay with their current provider. Appendix 1 contains a cost comparison and demonstrates that the cost differential between small and large lenders is not significant enough to warrant refinancing.

Suggested focus of the Committee

Many suggested solutions to increase the level of competition are focused on item # 3 above - cost. However, if we solve items 1 and 2, the Big Four will start to fear losing customers (a lot more than they do now) and I guarantee you that as a result competition, service and satisfaction levels will rise dramatically. Eliminate or reduce the risk of wasted time, hassle and fear of moving to an inferior service provider and borrowers will be far more willing to switch lenders. Consequently, banks will be forced to become more competitive.

We don't have to get borrowers to switch or artificially create banking alternatives to the Big Four. We just need to make it easier and simpler to switch and market forces will do the rest.

1. Make it easy, simple and cost effective

This initiative is similar to the portability of mobile phone numbers between telephone companies. Essentially, it means that you can retain the same bank account numbers even though you have switched lenders/banks. That means you don't necessarily need to change direct debit, payroll details and so forth making switching lenders far less painful. This will work very well for simple banking needs but might not work perfectly for more complex (multiple accounts) banking structure unless it's perfectly replicated. That said, I think it would eliminate nearly all the 'time and hassle' frustrations (point # 1 above).

Of course, there may be a significant cost associated with implementing this initiative and it can't be done overnight.

Another less effective but simpler solution would be to make it compulsory for all lenders to facilitate a refinance process within a statutory period. For example, if you were to refinance away from a bank, the incumbent bank had say 14 days to notify all vendors which you have a direct debit arrangement with and provide them with your new account number (and take reasonable steps to follow up to ensure these details are changed). Alternatively, this responsibility could be placed on the new lender.

Essentially, the mantra of this idea is to impose the responsibility of making refinancing hassle-free on the banks, not the consumer.

2. Help borrowers make informed decisions – increase market transparency

We suggest that the RBA should act as an independent umpire with the aim to create more transparency and reliable information for borrowers to make decisions. One of the difficult issues is knowing how justified any rate increases (independent of cash rate movement) are. The RBA recently said in its *Statement of Monetary* policy that the cost of funding has been relatively stable. CBA said that it's recently increased. The RBA said that the banks have fully passed on the cost of higher funding – CBA says it hasn't. It is our recommendation that any bank seeking to raise rates must disclose and justify the basis for the increase to the RBA for verification. This would hopefully create more transparency and help customers make sound and correct decisions. For example, if the market cost of funding had increased by 30% but a bank only passed on half of that increase then customers might view that as acceptable. However, in the situation where market costs had not changed and nor had the bank's actual cost of funds yet they increased rates, then customers are justified if they decide to take their business to a different provider.

Banks do not provide enough information publicly to verify whether they are justified to move their rates because it's commercially sensitive. I'm not suggesting they make this information public but just

disclose it to the RBA to verify it. This will create more transparency and keep the banks honest. If they honestly have a good case for increasing home loan rates then they have nothing to hide. The difficult thing recently is that they have reported enormous record profits and the RBA has been telling us there's no reason to increase rates, so a reasonable person is entitled to be sceptical about the bank's explanation.

3. The government can also reduce switching costs

There are a few government fees that can be abolished to reduce the cost of switching mortgages. In some States and in some situations mortgage stamp duty can be charged on refinanced loans. This can be quite substantial. Also, the titles office charges mortgage registration and deregistration fees (which range from $180 to $260). The federal government should insist on these fees be abolished for refinance transactions.

In summary: focus on making it easier to switch

If you go to a shop to buy a sandwich and the service is bad and sandwich is terrible, I bet you don't return to that same shop for a while. You essentially vote with your feet and 'market forces' means the business must either improve its service and food or go out of business. Essentially, we need the same in the mortgage market. We need the banks to fear losing lots of business should they offer bad service or make negative decisions about rates and fees. We also need independent verification of the reasons for any interest rate movements so that customers can make fully informed decisions based on trusted information (not bank or political propaganda). If the government focuses its attention on this, the free market system will work wonders and competitive pressures will work in customers favour.

For and on behalf of ProSolution Private Clients

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Appendix 1: Cost comparison – small versus large

The table below compares the total cost (i.e. interest rate and fees) of each of the top 5 lenders to two of the lowest cost independent lenders (AMP and ING) and one mortgage manager called PLAN Lending (note whilst PLAN is independently managed, it is owned by NAB so it's not strictly independent). PLAN is the only lender included in this table that does not have an offset.

The way to read the table is to look for the loan amount on the left hand column that best matches your loan amount and then compare your lenders cost to the independents.

I have compared the standard 0.70% interest rate discount (professional package) from the top 5 against the independents rates.

Total cost (rate + fees) per annum

	NAB	CBA	ANZ	Westpac	St George	AMP	ING	PLAN Lending
400,000	7.07%	7.20%	7.19%	7.26%	7.20%	7.05%	7.15%	6.98%
500,000	7.05%	7.18%	7.18%	7.24%	7.18%	7.04%	7.14%	6.98%
600,000	7.04%	7.17%	7.16%	7.23%	7.17%	7.04%	7.13%	6.98%
700,000	7.03%	7.16%	7.15%	7.22%	7.16%	7.04%	7.12%	6.98%
800,000	7.02%	7.15%	7.15%	7.21%	7.15%	7.03%	7.12%	6.98%
900,000	7.01%	7.15%	7.14%	7.20%	7.14%	7.03%	7.12%	6.98%
1,000,000	7.01%	7.15%	7.14%	7.20%	7.14%	7.03%	7.11%	6.98%

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