

ACCC RESIDENTIAL MORTGAGE PRICE INQUIRY FINAL REPORT

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Legal Briefings - By **Annalisa Heger** and **Ling Zhu**

On 11 December 2018, the Australian Competition and Consumer Commission (**ACCC**) released its final report into the Residential Mortgage Price Inquiry.¹

The ACCC examined the mortgage price decisions of ANZ, CBA, NAB, Westpac and Macquarie (the **Inquiry Banks**) from 9 May 2017 to 30 June 2018 and the factors that influenced those decisions. The ACCC also tracked the effect of the Major Bank Levy (only imposed on the Inquiry Banks) on mortgage pricing over the period.

The ACCC found no evidence that the costs arising from the Major Bank Levy have been passed onto residential mortgage borrowers.

However, the ACCC criticised the pricing approach of the banks as opaque, accommodative and synchronised and considered that the interest-only home loan benchmark announced by the Australian Prudential Regulation Authority (**APRA**) in March 2017 created a focal point for the Inquiry Banks to increase interest rates for interest-only residential mortgages.

OPAQUE PRICING

The ACCC found that there is a lack of residential mortgage price transparency which increases costs for borrowers and stifles price competition. Opaque pricing results in poor consumer outcomes, as the unnecessarily high search costs or effort required by borrowers to find better prices reduces their willingness to shop around. The Inquiry Banks profit from this and as a result lack a strong incentive to reduce price discovery costs.

The advertised headline interest rates are a poor indicator of the interest rate borrowers actually pay. Lenders often offer additional discretionary discounts on a case-by-case basis and typically after assessment of the borrower's application.

This feature of the market increases the time and effort of prospective borrowers to discover price information and meaningfully compare options. As a result many borrowers do not shop around or obtain more than one or two quotes either for a new residential mortgage or the refinancing of an existing residential mortgage.

This is particularly relevant for existing borrowers who do not actively shop around for a better deal on a regular basis. The ACCC found that on average new borrowers are paying lower interest rates than existing borrowers at the Inquiry Banks (a finding which the ACCC considered could be market-wide). Lenders earn higher profits from the loyalty of those borrowers as customer inertia means lenders do not need to compete vigorously on price to retain these borrowers.

SYNCHRONISED PRICING BEHAVIOUR

The ACCC found that Inquiry Banks take an “*accommodative and synchronised approach to pricing*”, instead of vying for market share.

There is a lack of competition for the lowest headline variable interest rates, and the ACCC found that two of the Inquiry Banks specifically aim not to be the lowest priced of the big four banks. In contrast, the non-Inquiry Banks take a much more varied approach to pricing, with three of the non-Inquiry Banks identified as specifically competing for the lowest prices.

In this environment, APRA’s interest-only home loan benchmark contributed to a “*common understanding*” between the Inquiry Banks. The benchmark – which ceased to apply from 1 January 2019 – required all Authorised Deposit Institutions (**ADIs**) to restrict growth in interest-only mortgages to 30% of total new residential lending to reinforce sound lending practices.

The ACCC found that absent the APRA benchmark, the big four banks would not have increased interest rates for interest-only mortgages to the same extent or at all. The ACCC estimated that the big four banks achieved revenue gains of \$1.1 billion for the 2018 financial year primarily as a result of this increase in interest rates. These revenue gains were largely from existing interest-only residential mortgage customers (even through the APRA benchmark only applied to new interest-only residential mortgages).

CHALLENGES FACED BY NON-INQUIRY BANKS

The lack of scale and branch network of the non-Inquiry Banks limits their ability to effectively compete with the Inquiry Banks. The ACCC considered that regulatory requirements – in particular APRA’s benchmarks and capital requirements – exacerbated the challenges faced by non-Inquiry Banks. The ACCC found that:

- non-Inquiry Banks are disproportionately affected by the APRA benchmark, as the

smaller mortgage portfolios restrict their ability to grant new mortgages;

- banks are typically able to reduce the amount of regulatory capital they must hold by using APRA-approved internal ratings-based (**IRB**) modelling. However the process to be accredited to use IRB modelling is expensive and time-consuming and as a result difficult for smaller banks to achieve; and
- non-Inquiry Banks are highly reliant on brokers and aggregators in sourcing mortgages, with some non-Inquiry Banks sourcing up to 95% of residential mortgages through this channel.

ACCC RECOMMENDATIONS

The ACCC identified a borrower's willingness to negotiate with their lender as an important factor in the pricing of their residential mortgage and encouraged borrowers to shop around and proactively review their residential mortgage products on a regular basis.

The ACCC also noted that the residential mortgage lending market in Australia would "*work better*" if the opaque pricing practices of lenders were "*reformed or otherwise circumvented*". In that regard the ACCC noted the Productivity Commission's recommendation for the development of an online calculator that reports median interest rates. It could help consumers to compare rates if tailored with different combinations of loan and borrower characteristics.

The ACCC considers the Consumer Data Right (**CDR**), which comes into effect for residential mortgages for the big four banks from 1 February 2020, will also facilitate the ability to compare and switch between residential mortgage products. The CDR – also known as Open Banking – is intended to promote competition and innovation in retail financial services as it will give consumers the right to share financial information with unaffiliated third parties to deliver enhanced capabilities to the marketplace, improving consumer outcomes.

ENDNOTES

1. A copy is available here: [ACCC Residential mortgage price inquiry Final report](#)

KEY CONTACTS

If you have any questions, or would like to know how this might affect your business, phone, or email these key contacts.



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