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Senate Standing Committees on Economics
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Helia welcomes the opportunity to provide a submission on the role of Lenders Mortgage Insurance (LMI) in supporting Home Ownership and Financial Stability.

This submission addresses two points under the terms of reference for the Inquiry:

- *APRA prudential standards and Corporations Act 2001 provisions for lending and whether they are adequately prioritising the goal of home ownership; and*
- *Effective priority treatment for aspiring Australian homeowners without compromising financial stability.*

The submission highlights the critical role of LMI in facilitating home ownership. It presents evidence as to how LMI plays a vital role in facilitating home ownership for a wider range of Australians while supporting the stability of the financial system and proposes specific policy recommendations to enhance the current regulatory framework to further support home ownership.

About Helia

Helia is Australia's leading provider of LMI. With almost 60 years in the Australian market, we continue to harness our experience, partnerships, and resources to help more aspiring home buyers accelerate their financial wellbeing through home ownership.

We believe owning a home brings with it housing security and lifestyle benefits, as well as long-term financial advantages. Buying a home with as little as a 5% deposit with LMI can help more Australians access these benefits sooner and provides an important pathway to home ownership.

Our product enables greater home ownership by transferring risk, giving lenders confidence to write loans with high loan-to-value (HLVR) ratios. This facilitates competition in the home loan market, providing home buyers with access to a greater range of lenders where deposit gaps exist.

Through 2023, Helia supported almost 43,000 home buyers achieve home ownership[1] by providing LMI to ~70 lending customers (from major and non-major banks, customer owned banks and non-bank lenders). At the end of 2023, Helia had a market capitalisation of ~$1.3bn and employed ~230 staff.

Since 2010, Helia has enabled over 1.2 million Australians to enter the housing market earlier than they would have been able to if they saved a traditional 20% deposit. On average, these buyers have been able to purchase their homes 5.5 years earlier, with the impact being even more significant in states like New South Wales (9 years earlier) and Victoria (8.5 years earlier)[2].

About LMI

LMI has been a cornerstone of the Australian housing market since its introduction in 1965 by the Australian Government through the Housing Loans Insurance Corporation (HLIC), with the aim of making home ownership accessible to more Australians. It plays a pivotal role in enabling lenders to offer high loan-to-value ratio (HLVR) loans to borrowers without 20% deposits. Since privatisation of the Housing Loans Insurance Corporation (HLIC) in 1997, LMI has contributed to home ownership and the stability of the financial system with no Government balance sheet exposure.

LMI protects financial institutions from losses in the event the borrower defaults on high LVR residential mortgages. It serves as insurance to cover the gap if the borrower defaults and the property's sale proceeds do not cover the borrower's outstanding debt. High LVR loans need risk mitigation due to a higher expected loss in default situations.

Typically, the cost of the LMI premium (~1 – 2% of the total loan amount) is passed on by the lender to the borrower as a fee, and the borrower has the choice to capitalise the cost of the LMI premium, effectively spreading the cost over the life of the loan.

LMI has multiple roles that are critical to individual home buyers, lenders, and the broader economy:

- **For home buyers**, LMI facilitates access to home ownership by directly addressing the barrier of large deposit requirements, expanding access to home ownership[3]. Our data indicates that without LMI, two-thirds of these home buyers would have been unable to purchase the same property within five years. Further, more than 80% of homebuyers would have been financially better off after five years by using LMI rather than waiting to save a 20% deposit[4]. Home buyers using LMI have, on average, accrued $107,000 in additional wealth (equity in their home net of the LMI premium) within five years compared with those who wait to save a 20% deposit.
- **For lenders**, LMI enables them to effectively diversify and manage the capital and risks associated with their mortgage books. As the risk is transferred, lenders become more willing to lend to home buyers with lower deposits. Further, it supports competition by leveling the playing field between larger financial institutions and new and smaller lenders that have more conservative capital requirements for High LVR lending. LMI providers also provide access to data and insights which gives smaller lenders the confidence to lend to a wider section of the population than they would based on their data alone.
- **For the broader economy**, LMI enables the freeing up of lenders' capital to lend to more borrowers due to the capital relief granted on loans insured with LMI. Further, because LMI providers are separately capitalised

[1] Helia FY23 Annual Report.
[2] Helia: internal data analysis, LMI data from 2010 to 2023.
[3] Helia Home Buyer Sentiment Report September: of those surveyed - 54% cite cost of living as the main barrier to entry, only 15% believe they can save a full 20% deposit, down from 41% in 2019.
[4] Helia: internal data analysis, LMI data from 2010 to 2023.

(from lenders) and pool risk across a broader portfolio of borrowers than any one lender, the average risk of the pool is reduced, contributing to stability of the financial system.

The impact to LMI from the Home Guarantee Scheme (HGS)

For the LMI industry to remain healthy, insurance must be issued across a good spread of lenders, risk levels, geographies, time horizons, and borrower segments. However, in recent years the volume of LMI business in Australia has reduced significantly and the types of risk insured have narrowed. This decline has been driven primarily by the expansion of the HGS to 50,000 places.

In the 2023/24 year the Federal government wrote 36,100 guarantees to first home buyers (FHBs) representing an increase of 34% from the previous year. In contrast, ~60,000 policies were issued over the same period by the whole LMI industry across a range of home buyers and investors (i.e., not just FHBs). As HGS recipients need to demonstrate their ability to service a loan in the same manner as for all borrowers, there is a very high level of overlap between HGS recipients and borrowers who would have qualified for the loan in any case using LMI.

The importance of a healthy LMI industry was noted extensively[5] when the First Home Loan Deposit Scheme (now HGS) was introduced in 2020. One of the Government's stated design objectives was for the Scheme to operate alongside a viable and sustainable private LMI market. At that time, the cap of 10,000 guarantees per year and property price caps were listed as key factors limiting the degree to which the Scheme would displace demand from FHB's that otherwise would have purchased LMI. The impacts were furthered emphasised[6] in the Grattan Institute 2019 submission where it noted "if the Scheme were expanded it would prove counterproductive: it would push up prices, benefitting sellers at the expense of first home buyers, while increasing the risks of inappropriate lending at costs to both households and government".

When the Scheme was expanded to 50,000 places in 2022, it was noted in Treasury's analysis[7] that the majority of successful applicants of the Scheme '...would have been able to purchase a property, either with the support of LMI or with a 20 per cent deposit, within one or two years' and that the Scheme assisted only ~12% of FHBs that may not have been able to enter the market i.e. 'genuinely additional homebuyers'. Further, the analysis highlighted that 'should LMI providers exit the market, the price of LMI contracts may increase and/or some lenders may instead increase the price of loans for high LVR lending as a substitute for an LMI policy.'

The impact of the HGS combined with other factors has resulted in the LMI industry lending contracting as a percentage of all High LVR lending from 61% in March 2019 to 39% in March 2024. Internal analysis estimates the impact of 50,000 guarantee places as a reduction of ~$420M revenue to the LMI industry.[8]

Other areas relevant to the Inquiry

Unequal Capital Treatment for similar risks

Unequal capital requirements applied to LMI, HGS and Parental Guarantees and varying risk weights for loans supported by these risk mitigants create an uneven playing field for similar risks.

APS 112 clearly states the capital treatment for loans supported by a government guarantee. The example in the table below demonstrates the risk weight being applied to HGS supported loans is significantly lower than the risk weight

[5] National Housing Finance and Investment Corporation Amendment Bill 2019 – Explanatory Memorandum
[6] Grattan Institute Submission to Inquiry into the National Housing Finance and Investment Corporation Amendment Bill 2019
[7] Home Guarantee Scheme Regulation Impact Statement – Treasury, 28 March 2022
[8] Assumes average LMI premium of $8,400

prescribed for loans supported by a limited Sovereign guarantee. This clearly provides preferential capital treatment for HGS supported loans.

To illustrate the point, the standard risk weight for a $600k property, at a 95% LVR (i.e., 5% deposit) is 70%. The risk weights across various low deposit solutions available in this scenario are below:

Bank capital required	Lenders Mortgage Insurance	With First Home Guarantee	With Guarantee (Sovereign)[9]	With Parental Guarantee
Variance to standard risk weight (70%):	-15%	-35%	-11%	-35%
Risk weight:	55%	35%	59%	35%

Key arguments for bringing risk weightings and capital requirements in line include:

- LMI-insured loans are lower risk than HGS, as LMI covers the full loss to the lender in a claim event and sufficient capital is held by the LMI provider. Conversely, in many instances, the HGS may not fully support lender exposure, as it only covers up to 15% of the loan value. Helia's data shows that the average loss in a default event is 23% of the loan value[10].
- Preferential capital treatment of the HGS undercuts the risk weights associated with Sovereign Guarantees and fails to accurately reflect the true risk of these loans. By Government policy, lenders cannot charge an interest rate reflective of the true risk.
- The most recent Banking Code Compliance Committee review identified several areas of non-compliance in relation to Parental Guarantees. Due to this and reputational concerns in enforcing a guarantee against family members, there is an increased risk that Parental Guarantee loans are unenforceable, further bringing capital adequacy into question.

Lending settings to enable home ownership

Recent commentary regarding lending settings has questioned whether banks are currently taking enough lending risk to support Australia's medium term economic prosperity. Several key trends including a contraction in the High LVR lending market (over the period 2019-2023 high LVR lending (above 80%) has fallen from 36% to 24% of lending), stronger underwriting disciplines and favourable claims experience for LMI providers appear to indicate that lending risks have decreased across the system over recent years.

Mortgage lenders will be better placed than Helia to provide a view as to which regulatory settings are most relevant to this change in aggregate risk level. We would suggest the Inquiry consider the impact of APRA's 3% servicing buffer and general approach to the proportion of high LVR lending banks take on, and AFCA's approach to determining responsible lending cases in the event of default.

Key issues this Inquiry should consider

Given the critical and long-standing role LMI has played in enabling access to home ownership and contributing to the stability of the broader financial system since its inception by the Government in 1965, we believe this Inquiry should consider the following key issues:

[9] As defined under Prudential Standard APS112
[10] Helia data; Average Severity

- The combined impacts of the HGS and disadvantageous capital treatment of LMI for lenders undermining the sustainability of the efficient private market LMI solution. A weakened or unviable LMI industry is likely to result in:
    - higher borrowing costs for customers and reduced product choice due to decreased competition in the lending market, noting the reliance of smaller lenders on LMI,
    - a diminished capacity for homeowners to borrow as smaller lenders scale back High LVR loans, significantly impacting those that are not eligible for Government Schemes,
    - limited ability for other types of home buyers who use the LMI market to participate in the housing system, including upgraders and investors, which would have significant flow-on impacts to home ownership,
    - a worsening of socio-economic issues of intergenerational equality, particularly for those unable to rely on parental support.
- The potential consequences of transferring risk from the private sector to government
    - Current arrears and losses on the HGS is low (0.1%) due to trends in the current property cycle,
    - Our LMI claims experience shows that portfolios do deteriorate over time, particularly in periods of economic weakness when government revenue is likely to be subdued. As a result, the true cost of the HGS over the long-term may not currently be reflected on the government's balance sheet.

Recommendations

Recommendation 1 – Refine HGS eligibility criteria: While the Scheme aims to support home ownership, it is important to maintain a balance that does not undermine the viability of the private LMI market or create excessive risk to government. To that end, to ensure continued access to home ownership for most of the home buyers ineligible for Government Schemes, and ensuring the viability of the LMI industry, the Inquiry should explore the appropriateness of the current Scheme settings. The objective should be to increasingly weight the Scheme eligibility parameters towards borrowers the LMI industry is less able to service.

Recommendation 2 – Re-assess HLVR risk weightings to better align them with current risk levels and potential financial system impacts: To promote long-term financial stability, credit risk mitigants should have capital treatment applied based on the relative risk mitigation they create. The Inquiry should explore the appropriateness of capital treatment across credit risk mitigant alternatives. This will allow for a more reasonable weighting and more even playing field between the HGS risk weighting and the private LMI lending requirements.

Recommendation 3 – Review regulatory stances on HLVR lending given ongoing low levels of system risk particularly where there are appropriate credit risk transfer mechanisms in place: We believe the current regulatory framework is likely not facilitating the banks in taking on sufficient risk to support medium term economic prosperity. We propose policy recommendations to reconsider regulations to encourage greater home ownership while maintaining financial stability, which would involve an explicit tolerance for a level of mortgage defaults and/or bad debts.

Helia welcomes the opportunity to further assist the Committee with this Inquiry. In the first instance, please direct any queries to Lisa Griffin, Chief Strategic Development Officer at Lisa.Griffin@Helia.com.au or on 0403 073 554.