SUBMISSION 20

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Submission in response to:

The House of Representatives Standing Committee on Economics inquiry into competition in the banking and non banking sectors

RESI MORTGAGE CORPORATION

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EXECUTIVE SUMMARY

As all participants in the Australian financial industry continue to review the impact of the credit crunch on their own specific business models, the events of the last twelve months have had particularly harmful implications for non-bank lenders.

It is now clear the future of the non-bank lending sector and the competition it brings to the marketplace has been placed in jeopardy and has, by necessity, placed the issue firmly at the Federal Government's feet.

As part of this enquiry, there are three key points that must be acknowledged:

1. Competition provided by non-bank lenders in the mortgage market has proven financially beneficial for consumers and must be preserved.

2. The Securitisation Market is now an essential vehicle for most lenders operating in the mortgage market to obtain funds outside of deposit bases and must be endorsed and supported as such by government.

3. Consumers will always benefit from innovation and choice but dedicated education programs must keep pace with the variety of loan products in the market.

With wholesale capital markets now established as an accepted funding option for the mortgage industry, including banks and non-banks, a government-backed mortgage agency would underpin the stability of these markets in Australia.

In doing so it would preserve competition and provide consumers with much needed choice, security and confidence when choosing a mortgage and a mortgage provider.

Such an agency would not only serve to provide stability for the end user i.e. the borrower, but would also deliver long overdue support to the very industry sector which has ostensibly been the champion of the Australian consumer i.e. the non-bank lenders.

As an established prime non-bank lender, Resi Mortgage Corporation strongly supports a proposal that will preserve the key benefits competition has brought to the market and ensure there are permanent funding structures in place which will allow prime non-banks in particular to continue to serve Australians – on the same level as banks.

This submission will provide valuable insight for a proposed funding model that supports competition in both the primary and secondary mortgage markets and, as part of a new national regulatory platform, will significantly insulate the Australian mortgage market from future situations similar to the last 12 months.

INTRODUCTION

As a prime non-bank lender, Resi Mortgage Corporation is one of the most established members of the non-bank lender sector with a dedicated commitment to consumer advocacy.

Despite the impact of the last 12 months on several other prime non-bank lenders Resi Mortgage Corporation continues to have solid long term funding arrangements with key partners, ING Direct, Challenger Group and on the Commercial lending front Sintex Consolidated.

This vital element of our business has been able to be protected and secured largely because of our respected reputation in the industry as well as our consistent track record with customers

Resi is acknowledged throughout the sector for the prudent and ethical lending standards we apply to our loans, predominantly in the prime category.

We therefore have a unique combination of knowledge and expertise which will enable us to provide valuable assistance to a working party on the concept of a regulatory body that incorporates a government backed funding agency funding agency that will:

- ✓ ***PRESERVE*** the benefits that non-bank lenders bring to the mortgage market through the competition they provide to the banks.

- ✓ ***SUPPORT*** the best interests of Australian consumers who have already reaped significant rewards from the competition provided by non-bank lenders.

Having already delivered tangible benefits to tens of thousands of customers throughout our 20 year history, we know first-hand that for consumers to benefit, they must continue to have access to a robust and competitive mortgage market which also protects their rights.

However, it is clear from the current state of the market that consumers are confused, angry and vulnerable in relation to all mortgage providers because they find themselves continuing to deal with the fallout from a US sub-prime crisis to which they were lead to believe early on, wouldn't affect them - particularly if they were in the safe haven of bank.

Or so the banks lead them to believe.

Although banks initially and strategically used the global credit squeeze to disparage the reputation of non-bank lenders in a clear bid to claw back market share, they then raised their own rates in most cases by more than non-banks, and outside of the RBA cycle.

Without any regulatory checks and balances to monitor or indeed rein in their behaviour, the banks conveniently cited exposure to sub-prime when and where it suited – in some cases ratcheting up rates to making up for corporate losses in other divisions of their bank.

As a result, their customers and those who took the flight to 'perceived' quality, were left bearing the brunt and feeling understandably deceived - with little recourse available to them through existing regulatory regimes.

It is therefore clear that bank behaviour hasn't inherently changed from the days prior to deregulation, when their standard variable rates were well above the official cash rate, and shareholders were top of mind, above customers.

Even now, as recently as early July the banks have publicly acknowledged that further rises are not out of the question in what they deem as necessary in offsetting their exposure to capital markets - and some have already started to move.

So, the big question is - how can we ensure we don't return to the monopoly by banks and all the confines it brings with it, whilst more consumer-friendly alternatives still remain an option through the competitive offerings of non-banks?

A new government backed mortgage lending agency issuing bonds available to the non-bank sector, as part of a broader nationally regulated platform on consumer credit, would ensure that this vital sector continues to provide the competition necessary for consumers to benefit from the mortgage market.

Such an agency will allow middle Australia and the incoming mortgage generation to confidently move forward and reap the true benefits of a competitive mortgage market.

To provide clear rationale to our submission we have documented the most pertinent information on the non-bank lending sector including the reasons for its emergence and its contributions to the Australian mortgage industry.

This information will assist the enquiry in understanding why we have suggested a range of essential elements that we believe must be part of establishing a government-backed mortgage agency.

A FIRST HAND ACCOUNT ON THE NON-BANK LENDING SECTOR

HOW AND WHY THE SECTOR EVOLVED

After industry regulation more than 20 years ago, non-bank mortgage managers emerged, primarily to provide effective competition to the banks for the direct financial benefit of Australian homebuyers.

By offering lower mortgage rates than the banks, the non-bank mortgage providers were over the next decade able to increase their market share of housing lending very quickly from around 2% to 8% of total approvals.

The non-banks premise was a simple one – by cutting their own margin on the bank bill rate on which they could borrow, with minimal overheads and a focus only on mortgages, they could loan the money to consumers more cheaply and offer previously unheard of savings on interest for consumers.

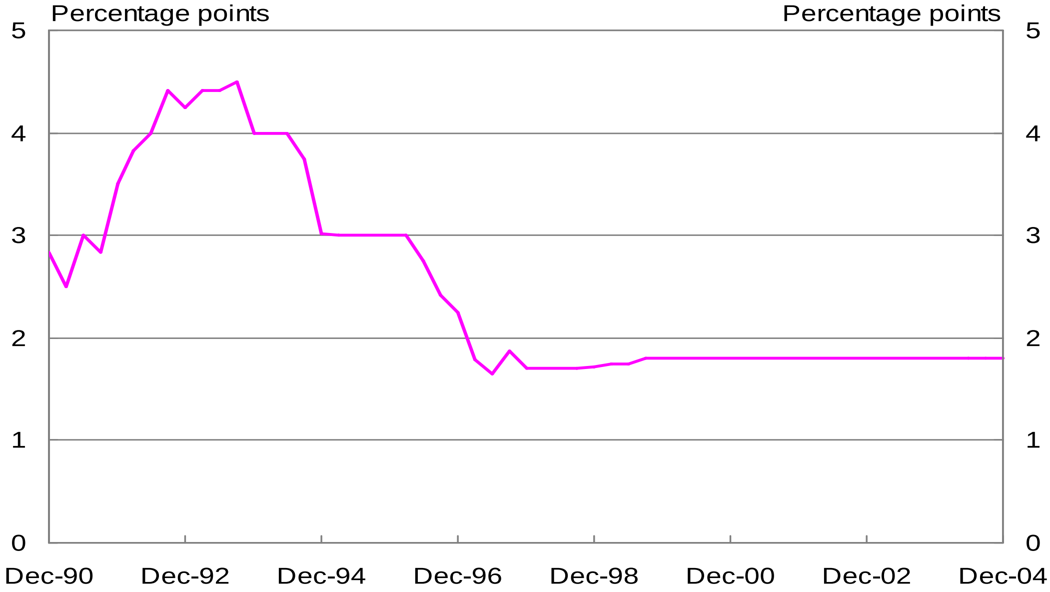
In essence, a star was born, but it highlighted the fact that it was something the banks could have done, but had never initiated.

The reasoning for the banks to not have ever dropped their own rates so that they were closer to the RBA cash rate was driven by their attraction to large profits – why would they decrease marginal rates when their customers had no alternative?

It was at this point banks inevitably moved to protect their market share and were forced to reduce their lending rates to meet the new competition.

As the graph below shows, the result was a reduction of more than 2% in the margin on mortgage lending over the cash rate.

BANK SPREAD ON HOUSING FINANCE OVER CASH RATE



Source: Commonwealth Treasury: Ken Henry, Secretary to the Treasury, Australia's International Engagement & Reform, Address to 2005 Economic & Social Outlook Conference, Melbourne, March 2005.

The key point to remember is that this represented more than 2% reduction in mortgage rates across the banks' loan books and is one of the major benefits of deregulation of the financial system.

And consumers have the emergence of non-bank lenders to thank for this windfall.

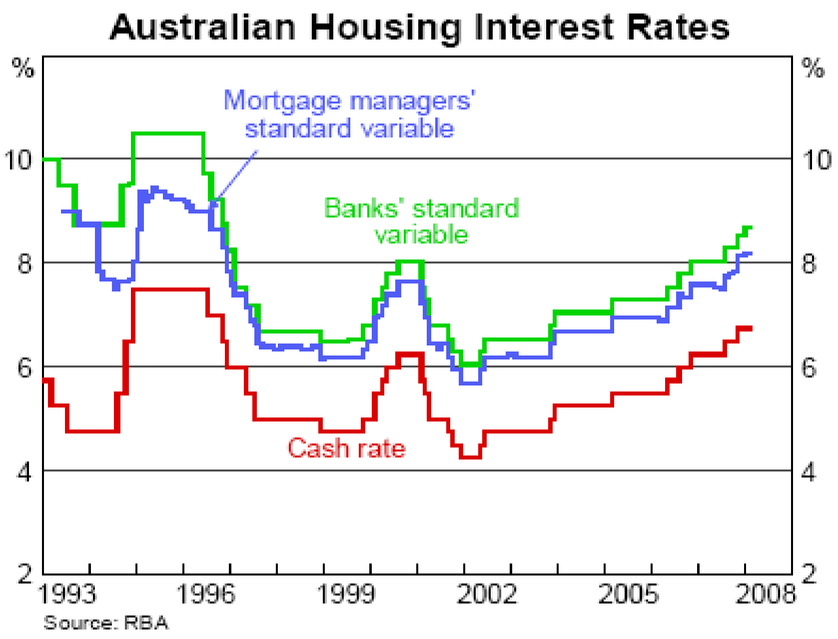
Commentators at the time said the new entrants were a breath of fresh air from the stranglehold created by the banks.

In essence, non-banks were illustrating the simplest rule of new competition – do the same thing as someone else has been doing, but do it better, and in this case the consumer was the beneficiary.

Instead of expensive housing finance being rationed by the banks, consumers were now able to benefit from the more plentiful supply of cheaper finance from a much wider range of providers.

As a result, non-bank lenders became the consumer's friend of and were embraced for the choice of products, savings and service levels they offered. Consumers were no longer constrained by the limitations imposed upon them for years by the bank oligopoly.

Reserve Bank statistics show that for the last 15 years it is the non-bank mortgage providers lending both directly and through mortgage brokers, who consistently offer lower average standard variable lending rates than the banks and have been responsible for reducing the spread on mortgage lending rates over the benchmark cash rate.



As result, the banks have not only been forced to meet the competition from non-bank mortgage providers by cutting their margins, they have also done an increasing proportion of their lending through mortgage brokers, particularly after they closed 2,000 bank branches.

The proportion of mortgages originated through brokers has continued to rise and is now around 40% of outstanding loans.

Over the last five years many founding and traditional members of the original fraternity have made strategic decisions to grow and change their businesses, Aussie Home Loans for example became a broker of loans in 2005 and RAMS Home Loans made the decision to sell their originated loans through brokers.

The Australian property boom and greater access to securitised funding then saw the mortgage market in Australia reach an unprecedented level of buoyancy – and with this came a surge in mortgage brokers and a proliferation of niche or specialist lenders. Everyone wanted to lend money, commissions were high – there was money to be made.

As a result, a dynamically changed mortgage marketplace is now made up of banks, prime non-banks mortgage providers, credit unions, building societies, non-conforming or sub prime lenders, brokers and lenders of last resort.

This has created a diverse range of sub-category non-bank lenders, more than often all categorised together as 'non bank lenders' for the sake of convenience and lack of understanding, which remains an issue for consumers - and for the market.

Accordingly, without any agreement on terminology, this has set the scene for consumer and indeed industry confusion and fragmentation - highlighting a clear need for consumer education to keep pace with the change in the industry.

TERMINOLOGY FOR THE SECTOR AND CONSUMERS

Much of the confusion and ignorance regarding the sector labeled as non-bank, can be largely attributed to a lack of consistency by the market in relation to the wide range of terms used within the sector.

Even within the industry there is conjecture as to how each company refers to their own business, and how others in the industry describe them. This leaves little opportunity for the borrower to understand what each term means and consequently, who is the most appropriate lender or mortgage professional for them.

At present, the following terms are all used when referring to the range of lending roles operating outside the banks:

- **Non-bank lender**
- **Prime non-bank lender**
- **Non-conforming lender**
- **Fringe Lenders**
- **Lenders of last resort**
- **Sub-prime lender**
- **Lo-doc/No-doc lender**
- **Mortgage Manager**
- **Mortgage Broker**
- **Mortgage Aggregator**
- **Mortgage Originator**
- **Mortgage Intermediary**
- **Finance broker**

Responsible also, are those who report the news and to some extent biased commentators who have influence over consumer opinion and buying decisions.

Almost every week in the major metro press and free to air television reporting, the term non-bank lender is misused and this repeated behaviour has resulted not only in confusion for borrowers, but a tarnished reputation for all 'prime' lenders that reside in that space.

As a lender for over 20 years, Resi, refers to themselves as a PRIME non-bank lender, a term used because they initially and still predominantly operate in the prime lending space.

This term, although not ideal, helps to differentiate our business from the non-conforming and lenders of last resort. We continue to use this term where appropriate in lieu of something more appropriate.

It is clear that terminology from within the sector must be uniformly accepted by the participants and then passed onto the consumer in order to address this issue.

The mortgage market has evolved and is now largely unrecognisable from twenty years ago – yet consumers have still managed to benefit in the absence of any dedicated education program.

With the new look industry regulated and consumers educated – these benefits can be magnified.

THE FINANCIAL MODEL OF NON-BANKS VS BANKS

There are significant differences between the business models and cost structures of bank and non-bank lenders which affects their value propositions.

Banks can be characterised as having lower average funding costs and higher fixed costs because of their deposit base and branch structure.

The non-bank lending model is mainly dependent on capital markets for funding and relies on the efficiency of service providers to competitively originate and service loans.

This was initially the clear difference between banks and non-banks when non-banks first emerged - but it is no longer that simple.

The lines between the two groups in relation to their reliance on capital markets is now blurred which is evident by the way in which the major banks have been forced to 'come clean' to customers by admitting how significantly they too relying on funding from capital markets as they manage their own internal battles with funding and interest rates.

It is now clear that relying predominantly on customer deposits for mortgage funding is a method which has become largely redundant. This is because over the last twenty years the use of consumer credit has increased and Australian savings levels have declined - a trend which is not set to change in the near future.

THE VALUE OF COMPETITION

It is important to recognise that since deregulation consumers have benefited more from the introduction of non bank mortgage providers than they have from the competition between the existing bank oligopoly.

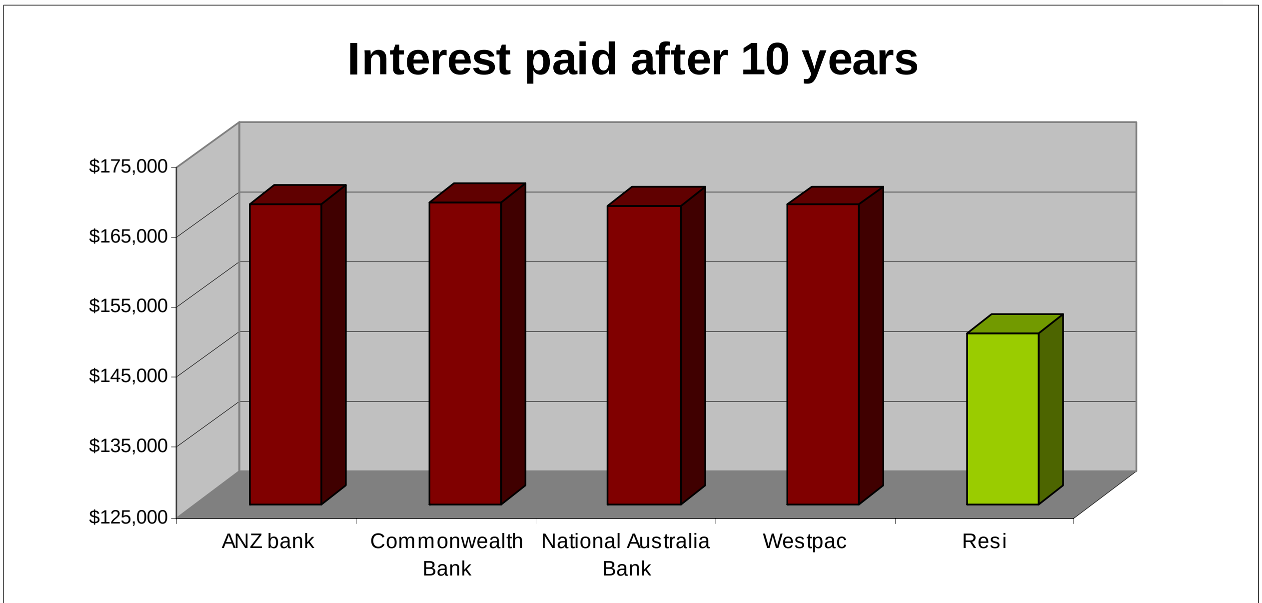
Non-bank lenders have introduced a number of product innovations, such as no-application fees and forced competition so that better loan flexibility was introduced. The ability to make multiple monthly payments, daily interest calculation and redraw facilities, were just some of the features that borrowers enjoy as standard today – developed purely out of competition.

Indeed, until the arrival of the prime non-bank lenders, many sections of the community including single women and many self-employed business people were locked out of the home loan market.

Non-banks have been able to take advantage of the consumers increasing dissatisfaction with the level of service offered by the banks which had become more impersonal and 'automated' and become true 'mortgage specialists'.

To illustrate this point, Resi has enabled borrowers to save thousands of dollars over the life of the loan e.g. on average, over the last 10 years, Resi's advertised standard variable rate has been more than 0.70% lower than that of the big four banks'.

The **saving** for the borrower has been more than **$54,000 in interest** on a **$300,000 loan** over **30 years**. A significant amount for most Australians.



Source: infochoice.com.au.
Note: Interest rate savings are based on a comparison of the advertised standard variable rates of the big 4 banks between October 1997 and March 2008.

Therefore the support for competition throughout the mortgage market is critical.

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The net result of competition in the mortgage market for consumers has been overwhelmingly positive and established a new set of 'norms' including:

- significant savings in interest over the life of a loan
- a wider range of loan features to suit a wider range of borrowers
- a return to personalised service with real people

What is also of paramount importance is what measures can be introduced to ensure the 'protection' of the non bank lending industry from powerful competitors.

The sector is currently being stalked by its big bank counterparts with the view to removing the option altogether for customers and obtaining greater market share.

In the same way that the four pillars policy was introduced to banking to ensure competition remained, this rationale must also be applied to the non-bank lending sector and will ensure the best practice operators remain.

The Federal Government must be aware not to introduce new controls which would diminish the significant benefits that consumers have obtained from financial deregulation.

ESSENTAL ELEMENTS OF THE *AUSSIEMAC* MODEL

There are three essential elements of the AussieMac model which should be considered in combination with a national regulatory platform.

The first issue of Government backed funding is clearly at the core of this paper and on the government agenda.

However, it would be remiss of us not to also include in this submission information on the additional merits that industry wide representation and consumer education can contribute to this enquiry.

Considered in conjunction with an AussieMac agency, these two additional elements of a regulatory platform will address the issues of:

- lack of industry wide cohesion
- updating consumers on the industry via an education program

We suggest these are also reviewed as part of your due diligence process.

1. GOVERNMENT BACKED FUNDING

It is clearly evident that the proliferation of AAA rated funding obtained by lenders since the emergence of securitisation has been the cornerstone of the mortgage market since industry deregulation more than twenty years ago.

If a government backed agency were established it would serve two critical purposes. It would support both the primary mortgage market of borrowers as well as the secondary market of investors operating within the securitisation market.

The stability provided to both groups would provide new opportunities for established non-bank mortgage providers to continue as mortgage specialists for the industry, as an ongoing and attractive alternative to banks and alongside the more localised lending options of credit unions and building societies.

However in order to achieve this we would expect that an agency would serve as a funding vehicle for prime loans only, so that alongside new regulatory reforms, the lending sector will be in the most effective position to assist deserving Australians realising the dream of home ownership.

Clearly there would need to be stringent criteria attached to the book quality of all the loans that can apply to the residential mortgage backed securities in question.

The concept of a federally backed government funding agency has already been successful in Canada, a country whose mortgage industry closely resembles Australia's – and key elements from that industry will no doubt provide potential blueprints for a similar agency in Australia.

2. INDUSTRY-WIDE REPRESENTATION

Despite its achievements and significant contributions to increasing the level of home ownership in Australia, the non-bank lending sector continues to be poorly represented as a sector.

There was a time however when this was not the case. In fact several key players in the non-banking sector were pivotal in the development of the Mortgage Industry Association of Australia (now known as the MFAA).

Over time the MFAA focus has shifted and with the proliferation of mortgage brokers on to the scene, and some significant non-bank players moving to broking, the priorities for the MFAA have transferred to mortgage brokers and the lenders they sell for – i.e. the banks.

Unlike the banks who are represented by the ABA, credit unions with ABACUS and mortgage brokers with a second support hub in the FBAA – non bank lenders are left exposed without any dedicated organisation to support, champion and nurture the industry.

And so, in 2002, the non-bank lending fraternity themselves came together in one voice and began an organization known as the Council of Mortgage Lenders (CML).

The agenda for the CML was simple, to unite as a single voice, identifying specific non-bank issues, working through satisfactory outcomes, educating consumers and constituents and continuing the role as mortgage specialists and innovators.

The association members were all members of the PRIME non-bank space – and the entity continued for around 2 years before lack of any external funding and resources resulted in it becoming dormant.

However, as a result of the events of the last twelve months the initial reasons behind the formation of a CML are now more necessary than ever.

Under the current CML banner Resi Mortgage Corporation continues to hold discussions with around a dozen prime non-bank lenders.

In the absence of any other form of representation and until that representation occurs – intended to occur through regulation, these discussions are the only avenue open to the sector in addressing the issues that continue to affect the non-bank sector.

Credible and active representation for the non-bank mortgage providers is critical and essential to the survival of the sector and the continued provision of competition in the mortgage marketplace.

To facilitate the further establishment of a CML type body and to ensure the non-bank sector is represented in the same way as banks, government funding and endorsement of its work is necessary alongside the formation of an AussieMac bank.

3. CONSUMER EDUCATION

Non-banks have also been unfairly represented to the public due to the additional absence of any dedicated information program on the scope of the non-bank lending sector since industry deregulation.

This lack of education has lead to confusion about exactly what a non bank lender is and affects the potential for consumers to select and use the most appropriate industry member for their circumstances

Through regulation a consumer education program can be carried out which informs them of the new playing field to which they have access to.

With a core focus on consumer advocacy, Resi strongly supports the introduction of an ongoing ***Government-funded Consumer Education Program*** in relation to the mortgage industry in general.

This program would integrate information for consumers on the mortgage industry in its current format and detail what is available to consumers - empowering them as an active player in their financial future, rather than a passive participant.

Such a program would seek to educate the market and consumers on:

- ✓ the very nature of the bank <u>and</u> non-bank lending sectors
- ✓ the characteristics of each lending group
- ✓ the consumer protection available through each participant; and
- ✓ the advantages and disadvantages of each.

In doing so this would address much of the misinformation and misconceptions which have been most recently attributed to the non-bank market segment and would contribute significantly to better informing the end user – i.e. the borrower.

Resi Mortgage Corporation already has an established consumer advocacy charter as part of its core business, with a dedicated public role filled by Resi's Head of Consumer Advocacy, Lisa Montgomery.

We would welcome the opportunity to assist the government in formulating the basis for such a consumer education program.

A critical point to include in this section is to consider that there is an entire generation of Australians, who have, in the absence of any dedicated education/information program, attempted to navigate their own way through an evolving mortgage market place and protect their finances.

Add to this the challenges faced by the same generation of Australian mortgage holders and credit users through the introduction of new forms of technology to deliver any information, and the case is clear for a long overdue educational program to ensure the Government is keeping Australians updated on the new regulated mortgage and credit platform.

It is clear that overhauling the mortgage industry has major implications for consumers and it is important that the measures put in place will enable them to, on the basis of accurate information, make decisions about:

- **Whether** to borrow
- **Where** to borrow, and,
- **The terms** on which they borrow.

Australians will then be able to fully reap the benefits of the industry – benefits which can flow into other areas of the economy.

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CONCLUSION

Put plainly and simply, without the competition provided by non-banks in the mortgage industry, the benefits that have evolved as a result of deregulation will be eroded and Australian consumers will ultimately pay more for their mortgages.

Even at this current time, despite the impact that the credit crunch has had on non-banks, the standard variable rates of prime non-banks are still around 70 basis points lower than banks. Which begs the big question - what would happen to the rates of banks if the competition ceased to exist?

And yet, that is the reality of the situation because apart from credit unions and building societies - that largely service the communities that they occupy – and without the robust competition provided by non-banks, the future looks bleak.

Through a new financial services regime that includes national regulation for lenders across all forms of consumer credit as well as greater access to well priced funds, it will provide much needed support to a consolidated non-bank market, and help the best practice operators ride out the credit crunch so they can continue to be a vital part of the industry.

Because of their size and power, banks have operated largely unencumbered for many years, so it is now time for non-bank lenders to be supported by government policy for the contributions they have made to the Australian mortgage industry.

This submission has been prepared in the hope that this is not too late. With so many middle Australians already suffering varying degrees of mortgage and credit stress if the government does not intervene to protect borrowers with long term strategies, the fallout will be more protracted and the damage from the repercussions, largely irreversible.

APPENDIX:

RESI MORTGAGE CORPORATION

Established more than 20 years ago by childhood friends Peter James and Jim Christie, Resi is regarded as one of the most reputable and successful prime non-bank mortgage lenders in the mortgage market.

Underpinned by funding relationships with respected institutions ING Direct and Challenger Mortgage Management – Resi offers AAA rated loan products to the people of Australia.

As a pure 'prime' non bank lender – customers can only purchase a Resi loan through a Resi branch – our loan products are not sold through broker channels.

The customer benefit in this model is that our mortgage managers retailing our products have a full understanding of all the benefits of our product range with a clear focus on customer service from loan approval through every life stage of the loan.

Resi is the only prime non-bank lender to have a dedicated Head of Consumer Advocacy, which remains a core focus of the business.

The company is still wholly Australian owned by joint managing directors Peter and Jim, who both commenced their careers in the lending sector during the 1970s.

Resi has won a string of awards including the prestigious Money magazine's Non-Bank Lender of the Year in 2006. They have just been named Lending Centrals Non-Bank Lender of the Year for 2007.

With more than 3 billion dollars under management and a national franchise network of 35 Resi branch managers around Australia – Resi mortgage is devoted to providing a clear alternative to traditional bank housing finance.

MANAGING DIRECTOR – MR PETER JAMES

Peter James is founder and joint managing director of RESI Mortgage Corporation, and one of the most respected individuals in the mortgage marketplace.

Peter has grown the Resi business from humble beginnings to one of the most successful non-bank franchise models in Australian history.

Together with other non-bank lending peers, Peter James has championed the Australian borrower and has played a significant role in providing competition in the mortgage sector resulting in significant savings for Australian borrowers.

Peter led the way in the early days of the MFAA (then known as the MIAA) – resulting in the first representative body for non-bank lending in Australia.

Peter has more than 30 years experience in property related lending and investment. Prior to founding Resi Mortgage Corporation in 1985, Peter held senior management positions with the nation's biggest consumer and property financiers.

HEAD OF CONSUMER ADVOCACY – LISA MONTGOMERY

With more than 25 years experience in the lending and finance sectors, Lisa Montgomery is a respected commentator and consumer advocate within the Australian financial services industry.

Lisa joined Resi Mortgage Corporation as Head of Consumer Advocacy in November 2004. Since that time Lisa has driven the Resi brand to the forefront of the mortgage sector, including winning the prestigious title of *Money* magazine's Non-Bank Lender of the Year.

Through this pivotal industry role Lisa provides quality advice and information to the Australian public on retail and consumer issues around lending and personal finances.

Using her established profile within the prime non-bank lender sector, Lisa has also been instrumental in the development of Australia's first Mortgage Management council, comprising the main players in the lending industries non-bank sector. As president, Lisa led the council to its official launch in August 2004.

Prior to her role at Resi, Lisa was Head of Consumer Information and Advocacy for Wizard Home Loans. It was during this same time she co-hosted the popular Lifestyle Channel television production of RETV (Real Estate Television) along with Residex's John Edwards and the ABC's Richard Morecroft.

Before her time at Wizard Home Loans, Lisa spent three years at financial services information provider and online ratings agency, Infochoice Ltd.

She initially joined Infochoice as product manager for their flagship website bankchoice.com.au and within the next two years was appointed Chief Executive Officer, where her innovative internet strategy increased users of their services to over 120,000 per month.

The company became widely recognised as a leading consumer advocate and industry authority, extending its services to include marketing and branding initiatives and research.

Lisa's career in the financial services industry began at the Newcastle Permanent Building Society in the 80s where she progressed from key sales roles to branch manager and at the end of her time with the company was the face for their TV advertising campaign.

Lisa is a Fellow of the Australian Institute of Financial Services, a registered JP, and an accredited lender and general insurance agent; she also held the role of President of the Council of Mortgage Lenders.