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Competition in the banking and non-banking sectors

House of Representatives
Standing Committee on Economics

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Chair’s foreword

Competition within the mortgage market has grown considerably since financial deregulation in the 1980s. In particular, the entry into the market of non-bank lenders and overseas financial institutions has resulted in greater competition, lower interest rates and margins, and an increase in mortgage products.

In August 2007, the collapse of the US sub-prime mortgage market disrupted wholesale funding markets around the globe making it extremely difficult for lenders to access funding, as well as undermining consumer confidence. During September 2008, the upheaval in financial markets escalated with large falls in equity prices and severe volatility across financial markets. As a consequence, a number of governments, most notably the US and the UK, implemented financial stability packages in an attempt to stabilise their financial systems.

During the past year there has been a noticeable increase in interest rates due to increases in the official cash rate but also increases in the cost of funding. Between January and September, Australia’s four largest banks increased their interest rates by an average of 100 basis points, of which 50 to 60 basis points were raised independently of the Reserve Bank of Australia’s (RBA) official cash rate. There has also been a reduction in the number of institutions offering home loan products.

Early in the year the rise in interest rates, combined with increasing petrol and grocery prices, put Australian households under financial pressure. Fortunately, the Reserve Bank of Australia, between September and November, reduced the official cash rate by 200 basis points to 5.25 per cent and the world price of oil is currently falling. The banks have passed on some of this rate cut but not all. For commercial rates to fall further the cost of funding needs to decrease and competitive pressures within the market place need to be more effective.

The non-banking sector, which has primarily used securitisation as the main source of funding, has found it particularly difficult to remain competitive in the current financial conditions. This has resulted in a decrease in competitive pressure within the banking and non-banking sectors.

The government is currently taking positive steps to increase liquidity both for the banking and non-banking sectors. There is still some uncertainty as to how long the recent downturn in the global financial market will last and the government should therefore continue to monitor the state of the market in light of any future developments.

The committee has also recommended that government examine a range of other proposals that could provide additional liquidity including expanding the RBA's repurchase agreements by extending their term to maturity even further and allowing Authorised Deposit-Taking Institutions to issue covered bonds.

In addressing matters relating to the state of competition, the committee received evidence on a range of other issues including: investigating and addressing issues of concern within the market; positive credit reporting; the government's account switching facilitation package; the regulation and entry and exit fees; and consumer protection for borrowers. The committee has recommended that:

- government review the current adequacy of the Trade Practices Act to extend the Australian Competition and Consumer Commission's powers;
- government implement the findings of the Australian Law Reform Commission's report recommendations on reforming Australia's credit reporting system;
- government review the account switching package in 12 months time and that consideration be given to including card schemes in the package;
- government consider mechanisms for making entry and exit fees more transparent and for addressing unfair entry and exit fees;
- government consider the feasibility of regulating unsolicited credit card limit increases;
- the Australian Securities and Investments Commission includes a glossary of standardised financial terms and Treasury develop a standardised key facts document for mortgage products to help consumers to compare financial products; and
- government make it compulsory for all credit providers to be a member of an external dispute resolution scheme approved by ASIC.

On behalf of the committee I would like to thank all of the groups that participated in this inquiry.

Craig Thomson MP
Chair

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Membership of the Committee

Chair	Mr Craig Thomson MP	
Deputy Chair	Hon Kevin Andrews MP (from 10/11/08)	
Members	Hon Julie Bishop MP (from 25/9/08)	Mr Richard Marles MP
	Mr David Bradbury MP	Ms Julie Owens MP
	Mr Steve Ciobo MP (from 28/8/08 to 10/11/08)	Hon Chris Pearce MP (to 10/11/08)
	Hon Peter Dutton MP (to 25/9/08)	Hon Tony Smith MP (from 25/9/08)
	Hon Joe Hockey MP (from 10/11/08)	Hon Malcolm Turnbull MP (to 28/8/08)
	Ms Sharryn Jackson MP	Mr Jim Turnour MP
	Mr Michael Keenan MP (to 25/9/08)	

Committee Secretariat

Secretary	Mr Stephen Boyd
Inquiry Secretary	Mr Paul Zinkel
Research Officers	Ms Stephanie Mikac
	Dr Cathryn Ollif
Administrative Officers	Ms Natasha Petrovic
	Ms Renee Van Der Hoek

Terms of reference

On 3 June 2008, the Treasurer requested the Committee to conduct an inquiry with the following terms of reference:

The Committee should examine competition in the retail banking and non-banking sectors in Australia. The inquiry will pay particular attention to home mortgage products and linked facilities frequently offered to consumers such as credit cards and savings accounts.

1. *The Committee will undertake a stock take of the Australian retail banking and non-banking industries, focussing on:*

    a) *recent developments in relation to products, providers and distribution channels;*

    b) *the current state of the retail banking and non-banking industries;*

    c) *the likely drivers of future change and innovation in the retail banking and non-banking sectors including the continuing impact of technological developments; and*

    d) *comparisons with relevant international jurisdictions.*

2. *The Committee will also identify any barriers that may impact on competition in the retail banking and non-banking sectors, and policies to enhance further competition and product choice for consumers.*

List of abbreviations

ABA	Australian Bankers' Association
Abacus	Association of Building Societies and Credit Unions
ACCC	Australian Competition and Consumer Commission
ALRC	Australian Law Reform Commission
AOFM	Australian Office of Financial Management
APCA	Australian Payments Clearing Association
APRA	Australian Prudential Regulation Authority
ARMs	Adjustable-Rate Mortgages
ASF	Australian Securitisation Forum
ASIC	Australian Securities and Investments Commission
ADI	Authorised Deposit-Taking Institution
BankWest	Bank of Western Australia
BECS	Bulk Electronic Clearing System
BSB	Bank State Branch
CALC	Consumer Action Law Centre
CCLC	Consumer Credit Legal Centre of New South Wales
CMHC	Canada Mortgage and Housing Corporation
COAG	Council of Australian Governments
CITE	Centre for Ideas and the Economy
CBA	Commonwealth Bank of Australia
DE Users	Direct Entry Users
EC	European Commission

Fannie Mae	Federal National Mortgage Association
FCS	Financial Claims Scheme
FHFA	Federal Housing Finance Agency
FIDO	Financial tips and safety checks
Freddie Mac	Federal Home Loan Mortgage Corporation
FSR	Financial Stability Review
FSRA	Financial Services Reform Act
HBOS	Halifax – Bank of Scotland
IMF	International Monetary Fund
Lloyds TSB	Lloyds Bank and the Trustee Savings Bank
ME Bank	Members Equity Bank
MFAA	Mortgage and Finance Association of Australia
NAB	National Australia Bank
OECD	Organisation for Economic Cooperation and Development
OFT	Office of Fair Trading
Repo	Repurchase agreement
RBA	Reserve Bank of Australia
RBS	Royal Bank of Scotland
RMBS	Residential Mortgage Backed Securities
SPV	Special Purpose Vehicles
UCCC	Uniform Consumer Credit Code
UK	United Kingdom
US	United States of America
WBC	Westpac Banking Corporation

List of recommendations

Options to increase competition

The committee believes that the 'AussieMac' proposal is not a suitable model for the Australian context.

The committee supports the move by the government to have the Australian Office of Financial Management (AOFM) allow both Authorised Deposit-Taking Institutions (ADIs) and non-ADIs to purchase $8 billion in RMBS over the next 3 years.

The committee believes that the actions taken by the government are positive steps toward adding additional liquidity within the market.

Recent difficulties in the Residential Mortgage-Backed Securities (RMBS) market, as a consequence of the global financial crisis, have made it difficult for some mortgage providers to actively compete in the mortgage market. As a result, the committee welcomes the government's initiatives to invest $8 billion of RMBS in order to support recovery in the RMBS market.

Recommendation 1

The committee recommends that the government continue to monitor the state of the Residential Mortgage-Backed Securities market and review the adequacy of the current level of investment in light of future market developments.

Reserve Bank of Australia's repurchase agreements

The committee supports the steps taken by the Reserve Bank of Australia (RBA) to widen the range of securities that it will accept as collateral and to lengthen the term to maturity.

The RBA repurchase agreements are an effective tool for adding short term liquidity to the market. However, there is still a concern that expanding the repurchase agreements by extending their term to maturity even further may place additional unnecessary risk on the RBA.

The committee believes that while there is merit in the proposal to make repos a long term funding option, further study on whether this will place additional risk on the RBA needs to be undertaken.

Recommendation 2

The committee recommends that the Reserve Bank of Australia examine the appropriateness, feasibility and risks of expanding the repurchase agreements by extending their term to maturity even further and provide a public audit report within six months. The report must be made available to the committee for review.

Covered Bonds

The committee believes that further study on how covered bonds would be regulated needs to be undertaken.

Recommendation 3

The committee recommends that the Treasury examine the appropriateness and feasibility of allowing Australian authorised deposit-taking institutions to issue covered bonds.

Investigating and addressing issues of concern

The *Trade Practices Act 1974* already contains a broad range of investigation and enforcement powers in relation to suspected breaches of the Act including, mechanisms to monitor competition in particular industries, and substantial penalties for breaches of the competition provisions. There are also a range of general consumer protection powers.

Some concerns were raised with the committee regarding whether the current mechanisms were adequate to monitor the state of competition within the banking and non-banking sectors.

Recommendation 4

The committee recommends that the government review the current adequacy of the Trade Practices Act 1974 *to provide the Australian Competition and Consumer Commission the powers to investigate and address issues of concern in markets and regulated sectors.*

Positive credit reporting

The committee concurs with the Australian Law Reform Commission's (ALRC) recommendation that there should be some expansion of the categories of personal information that can be included in credit reporting information held by credit reporting agencies.

Recommendation 5

The committee supports the findings of the Australian Law Reform Commission's report and urges the government to implement the report's recommendations on reforming Australia's credit reporting system.

The account switching facilitation package

Card scheme inclusion in the switching regime

The committee supports the combined effort of the government and the Australian Payments Clearing Association (APCA) to encourage card schemes to participate in the new switching regime.

The committee accepts that it is relatively easy for consumers to switch between card schemes. However, the committee notes that a consumer that holds a mortgage may also hold a credit card with the same mortgage provider and so may feel inhibited from switching between card schemes.

Recommendation 6

The committee recommends that consideration be given to including card schemes in the Account Switching Package.

Account number portability

The committee accepts evidence, which suggests that a central account registry could improve the efficiency of switching between financial institutions, but also understands that there may be significant costs in moving from a bilateral to a more centralised system.

The committee would like to see an examination of the costs and benefits of implementing a system, which could support a more centralised account switching process which would allow financial institutions to undertake this process on behalf of the consumer. The committee also believes that privacy considerations need to be taken into account under such a model.

The committee is aware that Australia's payments system operates differently to that of The Netherlands. However, the committee would also welcome a thorough investigation of the costs and benefits of implementing a switching system similar to that of The Netherlands.

Recommendation 7

The committee recommends that after 12 months in operation, the Treasury review the Account Switching Package with consideration being given to any areas in which it may be enhanced, including consideration of the costs and benefits of a more centralised account switching system, such as those in operation in the UK and The Netherlands.

Regulation of entry and exit fees

The committee acknowledges that there is community concern about the current level of entry and exit fees on some mortgage products.

Recommendation 8

The committee recommends that, as part of the adoption of responsibility for the regulation of credit and the introduction of a national consumer policy framework, the government consider mechanisms for making entry and exit fees more transparent and for addressing unfair entry and exit fees.

Consumer protection for borrowers

Financial literacy

The committee supports the goals and objectives of the Financial Literacy Foundation and encourages it to build on the work it has already done.

Furthermore, the committee believes it could be most useful to people who are trying to understand the products which are available if there were a glossary of standardised financial terms in very simple language. This glossary could be placed on both the Australian Securities and Investments Commission's (ASIC) consumer website and the Understanding Money website.

Recommendation 9

The committee recommends that the Australian Securities and Investments Commission includes a glossary of standardised financial terms in simple language on its consumer website and also on the Financial Literacy Foundation's website.

Predatory practices relating to credit cards

The committee agrees that it is an undesirable practice for lenders to push people to increase their credit limits regardless as to whether or not those people are able to understand the implications of taking on more debt or if they will be able to repay the increased debt.

Recommendation 10

The committee recommends that, as part of its adoption of responsibility for the regulation of credit, the government consider the feasibility of regulating unsolicited credit card limit increases.

Consumer information to compare products

The committee believes that, in addition to the work Treasury is doing to improve product disclosure, there is a need in Australia for some sort of standardised 'key facts document', similar to the UK model, to help consumers to compare effectively mortgage products.

Recommendation 11

The committee recommends that the Treasury develop a standardised key facts document for mortgage products, based on the UK model, to help consumers to compare financial products. The standardised key facts document must be provided to the committee within twelve months.

External dispute resolution

The committee notes that there is currently no legal obligation for providers of credit or financial advice associated with credit, other than ADIs, to belong to an external dispute resolution scheme, although some non-ADIs voluntarily belong to such schemes.

In view of the concerns expressed by CHOICE and other stakeholders, the committee welcomes and supports the creation, as part of government reforms of the financial services regulatory regime, of an external dispute resolution body to which all licensed lenders must belong, to be introduced by mid-2009.

Recommendation 12

The committee recommends that, as part of its adoption of responsibility for the regulation of credit, the government make it compulsory for all credit providers to be a member of an external dispute resolution scheme approved by the Australian Securities and Investments Commission, as is currently the case for deposit-taking institutions.

1

Introduction

Background

1.1 In the last 18 months there has been a significant upheaval within global financial markets. The US sub-prime mortgage crisis which first became evident in August 2007 has sent the cost of funding sky–rocketing.

1.2 Over the last year, both the banks and the non-banks (lenders who are not banks, building societies or credit unions) have recouped some of their funding losses by increasing their interest rates independently of the official cash rate set by the Reserve Bank of Australia (RBA).

1.3 The non-banking sector has been hit particularly hard by the economic fall out of the US sub-prime crisis. Some non-banks have been forced out of business while others have had to reduce their lending funded through securitisation. These developments have concerned some groups who argue that the decline of the non-banking sector has reduced competition and subsequently commercial interest rates have risen sharply putting substantial pressure on the average Australian household.

1.4 Others are less concerned and argue that this is a normal cyclical market event and that once the market rights itself again the non-banking sector will return and with it greater competition.

1.5 With this background in mind, on 3 June 2008 the Treasurer, the Hon Wayne Swan MP, asked the House of Representatives Standing

Committee on Economics to inquire into and report on the extent to which competition in the banking and non-banking sectors has reduced and, in particular, examine proposals that could help to increase competition and reduce fees and charges for people struggling with their mortgages.

Objective and scope

The state of competition

1.6 The rise of the non-banking sector in the early 1990's played a significant role in enhancing competition particularly in the mortgage industry. The non-bank lenders introduced innovations such as internet and phone banking and mobile lenders. This put pressure on the banks resulting in greater competition, tighter margins and lower interest rates.

1.7 The non-banking sector opened the way for 'mortgage brokers' to enter the market. Brokers acted as a 'one stop shop' for consumers by providing advice on the numerous home loans available.

1.8 Prior to the commencement of the credit crisis, the non-bank sector sourced their funds primarily from securitisation ('bundling' individual loans and selling them in financial markets).

1.9 In the last 12 months the global securitisation market has all but dried up and as a consequence the non-banking sector's market share 'has fallen from around 12 per cent in 2006 to 5 per cent.'[1]

1.10 The lack of available funding has forced some providers and brokers out of the market. Less providers within a market would normally result in a fall in competition.

1.11 There are, however, two opposing views about the current state of competition within the banking and non-banking sectors.

1.12 The Treasury, the Reserve Bank of Australia and the big four banks, Westpac, ANZ, the Commonwealth Bank and National Australia Bank, believe that competition within the sector is strong and that the non-banking sector will regain its market share when market conditions normalise again.

1 Reserve Bank of Australia, *Submission no. 12*, p. 4.

1.13 The non-banking sector, including the Mortgage and Finance Association of Australia, the Australian Securitisation Forum, and Challenger Financial Services Group, to name a few, believes that there is some uncertainty about how long it will take for the funding markets to return and that as a consequence competition will be substantially reduced.

1.14 The inquiry presented an opportunity to identify the barriers and drivers of competition within the sector and consider policies to enhance further competition and product choice for consumers.

The current state of the retail banking and non-banking industries

1.15 The Treasury noted in its submission, that 'the Australian financial system and its regulatory framework have demonstrated their effectiveness and resilience over recent months during a period of severe stress resulting from global financial market turbulence.'[2]

1.16 While that may be the case, it is clear that the number of competitors and products within the banking and non-banking sectors has reduced.

1.17 According to the October 2007 *Mortgage Star Ratings* report issued by financial services research firm CANNEX, Australia had over 150 financial institutions offering over 2,117 home loan products.[3]

1.18 The most recent report has shown that the number of home loan products has dropped significantly with 1,750 products now being offered by over 140 financial institutions. [4]

1.19 The Treasury also noted that 'bank lenders increased their market share of new home loans from 79 per cent in 2007 to 89 per cent in April 2008, largely at the expense of non-Authorised Deposit-Taking Institutions (ADI) lenders.'[5]

1.20 The recent turbulence in the global financial market and the impact this was having on the domestic home loan lending industry emphasised the need for a review of the adequacy of competition, including an assessment of how exposed our financial institutions are to the global credit squeeze.

2 Treasury, *Submission no. 32*, p. 8.

3 CANNEX, *Mortgage Star Ratings, Report No. 20*, October 2007.

4 CANNEX, *Mortgage Star Ratings, Report No. 22*, September 2008.

5 Treasury, *Submission no. 32*, p. 9.

The impact of the credit crisis

1.21 The credit crisis has had a wide ranging effect on Australia's financial institutions. In addition, the crisis has had a social and economic impact resulting in falling shares, rising costs of funding and a fall in individual wealth and income.

1.22 The credit crisis placed funding pressures on financial institutions, and, in particular, non-bank lenders that relied entirely on access to securitisation for their funds. Collins Securities commented that:

> 12 months ago the pricing of that issue [Residential Backed Mortgage Securities] would be probably around 20 basis points into the market. That cost has now risen to around 150 basis points. So there has been almost a tenfold increase in the cost of funding.[6]

1.23 Some non-bank lenders, being unable to source any funding, have left the market; have been bought out, as is the case with RAMS Home Loans; or stopped selling new mortgages, like the Macquarie Group. Other non-bank lenders have slightly changed their focus, as is the case with Aussie Home Loans who are acting as a mortgage broker in addition to offering their own home loans. [7]

1.24 The added funding pressure also led to financial institutions raising their interest rates independently of the RBA. 'Between January and July 2008, the major banks increased their interest rates by 0.5 to 0.6 percentage points more than the increases in the RBA's cash rate.'[8]

1.25 The Treasury noted that 'to recover some of their increased funding costs…a significant number of borrowers have experienced interest rate rises of 1.5 to 1.6 percentage points over the year to July 2008, comprised of 1 percentage point due to increases in the RBA's cash rate, and 0.5 to 0.6 basis points due to independent interest rate rises by the major lenders'.[9]

1.26 Between September and November 2008, the RBA board decided to lower the official cash rate by 200 basis points.[10] In its 7 October media release, the RBA noted that 'conditions in international financial

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6 Mr J Emmett, Collins Securities Pty Ltd, *Transcript*, 8 August 2008, p. 30.

7 Mr C Joye, Centre for Ideas and the Economy, *Transcript*, 21 August 2008, p. 62.

8 Treasury, *Submission no. 32*, p. 9.

9 Treasury, *Submission no. 32*, p. 9.

10 Reserve Bank of Australia, *Media Release*, 2 September 2008, 7 October 2008 and 4 November 2008.

markets took a significant turn for the worse in September' and that 'financing is likely to be difficult around the world for some time ahead.'[11]

1.27 Fujitsu Consulting have highlighted that:

> …despite recent cash rate reductions, growing unemployment, house price falls and the global financial market difficulties will all conspire to bring more households into some degree of mortgage stress. This could reach over 1 million households by March 2009.[12]

1.28 However, 'default rates are currently still well below historical peaks in the last 10 to 15 years.'[13]

1.29 It was therefore timely that the committee examine the overall impact of the credit crisis on the sector as a whole and in particular how it has affected home owners and prospective buyers.

Chronology of events

1.30 During the course of this inquiry there has been a significant upheaval within the global financial system.

1.31 Table 1.1 below provides a brief overview of the key events that took place during the course of the inquiry, both within Australia and globally.

Table 1.1 Key events in the global financial crisis

Date (2008)	EVENT – AUSTRALIA	EVENT – INTERNATIONAL
2 June	Treasurer announces introduction of a Financial Claims Scheme for depositors and policyholders.	
3 September	Reserve Bank of Australia cuts cash rate by 0.25% to 7.00%.	
7 September		Fannie Mae and Freddie Mac are placed into conservatorship by the US Government.
14 September		Lehman Brothers files for bankruptcy.
19 September		US Treasury Secretary Henry Paulson announces US$700 billion rescue package.
26 September	Australian Government announces $4 billion investment in RMBS.	

11 Reserve Bank of Australia, *Media Release*, 7 October 2008.

12 Fujitsu Consulting, *Press Release, Mortgage Stress Worst Ever By March*, 23 October 2008.

13 Mr C Joye, Rismark International, *Transcript*, 21 August 2008, p. 61.

29 September		Bradford and Bingley mortgage book nationalised by the UK Government.
29 September		Paulson's rescue package defeated in US House of Representatives.
3 October		Paulson's rescue package passed and signed into law.
6 October		The US Federal Reserve announces it will provide $US900 billion in short-term cash loans to banks.
8 October		The IMF releases its revised forecast for the global economy, which anticipates a major global downturn.
8 October	Reserve Bank of Australia cuts cash rate by 1.00% to 6.00%.	
8 October		The UK announces a guarantee of new short and medium term debt issuance and a facility to provide for new capital to UK banks and building societies.
6–10 October	The All Ordinaries lost 16.1 per cent (closing at 3,939.50 on 10 October down from an opening of 4,697.80 on 6 October).	Major downturn in the world's stock markets. The US Dow Jones lost 22.1 per cent, its worst week on record.
11–12 October		Meetings of the G7 and G20 in Washington agree to urgent and unprecedented coordinated action to address the credit crisis, including the strengthening of depositor protection and measures to assist financial institutions to raise new funds.
12 October	Australian Prime Minister Kevin Rudd announces Australian Government guarantees on deposits and wholesale funding. Also announces additional $4 billion investment in RMBS.	
13 October	Australian Prime Minister Kevin Rudd announces $10.4 billion in economic stimulus package.	
14 October		The US announces it will use the $700 billion available from the Emergency Economic Stabilization Act to inject $250 billion into US banks in return for non-voting equity.
17 October	Financial Claims Scheme legislation receives Royal Assent.	
23 October		The Canadian government announced a voluntary guarantee facility (for six months) on the wholesale term borrowing of federally regulated deposit-taking institutions of up to C$218 billion ($A263 billion).
24 October	Treasurer announces further details of Government guarantee arrangements, including $1 million deposit guarantee threshold.	
5 November	Reserve Bank of Australia cuts cash rate by 0.75% to 5.25%.	

1.32 The inquiry has been taken over to some extent by further financial shocks to global financial markets. Governments around the world responded with unprecedented steps to bolster financial stability both domestically and globally.

1.33 Initially, the committee's inquiry was focussed on the current state of competition within the banking and non-banking sectors, and in particular home mortgage products. As the global financial turmoil unfolded, the focus quickly changed to the overall stability of the financial sector.

The mortgage market and other financial services

1.34 The terms of reference called on the committee to pay particular attention to home mortgage products and linked facilities frequently offered to consumers such as credit cards and savings accounts.

1.35 The majority of evidence focused on the adequacy of competition with home mortgage products.

1.36 In addition, concerns were raised about credit cards, including unsolicited pre-approved credit offers, and the need to increase the ease with which customers can switch between providers.

Conduct of the inquiry

1.37 The inquiry was advertised nationally on 5 June 2008 and subsequently received 58 submissions from a broad cross section of interested parties.

1.38 Between August and October 2008 the committee held a total of 6 public hearings in Canberra, Sydney and Melbourne.

1.39 A list of submissions, exhibits and public hearing witnesses can be found at appendices A, B and C respectively.

1.40 Submissions received and transcripts of hearings can be found at the committee's website: www.aph.gov.au/economics

1.41 Mr Adrian Russell, Department of the Treasury, assisted the committee by undertaking a technical edit of the report.

Reader guide and structure of the report

1.42 This report has been structured in an easy-to-read format. In discussing each issue, evidence and other relevant material is provided, followed by the committee's conclusions, and then, in some cases, a recommendation.

1.43 Chapter 2 of the report provides an overview of Australia's mortgage market prior to and after the rise of the non-bank lending sector; the effects of the credit crisis on competition; and how Australia's mortgage market sits within the global financial marketplace.

1.44 Chapter 3 looks at various options designed to increase competition including adding additional long term liquidity to the market, the benefits of a positive credit reporting model and investigating and addressing issues of concern in the future.

1.45 Chapter 4 examines the banks switching regime including the current barriers to switching and the Australian account switching facilitation package.

1.46 Chapter 5 considers ways in which consumers can be empowered to make educated financial decisions and protect themselves from fringe predatory lenders.

2

Competition in the mortgage market

Introduction

2.1 In the last 20 – 30 years there has been significant economic reform within the financial sector, a key component of which has been deregulation in the 1980s.

2.2 Financial deregulation opened the door to allow both international and non-bank lenders to enter the market which has resulted in greater competition, lower interest rates and margins.

2.3 This chapter provides some background on how the mortgage market has evolved and, in particular, the effect that the credit crisis has had on competition.

The mortgage market – pre and post 1992

2.4 Up until the 1950s, competition within the mortgage market was limited to a handful of banks, building societies and life insurance companies. 'Banks faced little competitive pressure from other institutions, which had not yet begun their rapid development, and the system was not open to foreign bank entry or to offshore transactions.'[1]

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1 M Edey and B Gray, Reserve Bank of Australia, *The Evolving Structure of the Australian Financial System*, October 1996, p. 4.

2.5 During the 1960s and 1970s banks had tighter regulatory requirements placed on them. This put banks at a competitive disadvantage and as a result they lost their market share 'when corresponding gains were made by non-bank financial intermediaries, particularly building societies, finance companies, merchant banks and, later, unit trusts'.[2]

2.6 Financial deregulation in the 1980s allowed banks to compete more effectively with the building societies, finance companies and merchant banks and, consequently, they regained their market share. Financial deregulation also opened the mortgage market to international competition and allowed financial institutions to access greater amounts of credit to support an increasing demand.

The rise of the non-banking sector

2.7 The non-banking sector took off in 1992 with the establishment of 'mortgage manager' Aussie Home Loans. Using securitisation as a means to obtain readily available and cheap funding, mortgage managers were able to offer lower interest rates than the existing lenders. Within 3 years, 'mortgage managers accounted for almost 10 per cent of housing loans written.'[3]

2.8 The Mortgage and Finance Association of Australia (MFAA) was of the view that the non-banking sector 'has been very much a driving force for competition in the industry over the last decade or so.'[4]

2.9 The increased competition within the sector, including a greater demand for housing, also opened the way for specialist mortgage advisors to enter the market – the mortgage broker.

2.10 There were some downsides to the increased competition. Having lost some market share, the banks closed down a number of branches, especially in regional areas, and staff lost their jobs. Fees and charges also rose dramatically after the early 1990s. The Treasury noted that 'between 1997 and 2007, banks' total fee income rose from $3.9 billion to $10.5 billion, an increase of $6.6 billion or 170 per cent.'[5]

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2 M Edey and B Gray, Reserve Bank of Australia, *The Evolving Structure of the Australian Financial System*, October 1996, p. 5.

3 M Gizycki and P Lowe, Reserve Bank of Australia, *The Australian Financial System in the 1990s*, July 2000, p. 195.

4 Mr P Naylor, Mortgage and Finance Association of Australia, *Transcript*, 14 August 2008, p. 42.

5 Treasury, *Submission no. 32*, p. 6.

2.11 The non-banking sector continued to increase its market share up until the start of the global credit crisis in August 2007. After that time, the cost of funding increased and the non-banking sector, unable to obtain competitive funding, was no longer able to compete. As a result, the non-banking sector's market share dropped by more than half.

2.12 Challenger Financial Services Group highlighted the reduction of market sharing stating that 'non-banks had a market share of 12.1 per cent prior to the subprime crisis and now have only 4½ per cent.'[6]

Product development and bank lending margins

2.13 In addition to lower interest rates, the non-banking sector was innovative offering many varied products. Some products now available include non-conforming loans, reverse mortgages, shared equity mortgages, internet and phone banking, mobile mortgage lenders, redraw facilities, offset accounts, and debit cards linked to mortgages, to name a few.

2.14 Aussie Home Loans, PMI Mortgage Insurance, Resi Mortgage Corporation, and the Australian Securitisation Forum were all of the view that the non-banking sector was at the forefront of financial product innovation.

2.15 The Reserve Bank of Australia (RBA) similarly noted that the new players in the mortgage market 'have been able to take advantage of financial innovation and improvements in technology, and have led to significant reductions in the prices of a range of financial services.'[7]

2.16 In addition to the non-banking sector, foreign-owned banks have also contributed to product innovation in the Australian market by introducing products such as high interest online savings accounts.[8]

2.17 The RBA noted that the number of financial products had increased over time indicating that 'over the past 15 years we have seen a marked increase in the range of financial products available in Australia' and that 'the experience here compares quite favourably with the experience overseas.'[9]

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6 Mr D Cox, Challenger Financial Services Group, *Transcript*, 15 August 2008, p. 75.

7 Reserve Bank of Australia, *Submission no. 12*, p. 1.

8 Reserve Bank of Australia, *Financial Stability Review*, March 2007, p. 48.

9 Mr R Battellino, Treasury, *Transcript*, 14 August 2008, p. 3.

2.18 The increased pressure that the non-banking sector placed on banks led to the banks emulating many of the new products that were being offered. The Australian Bankers' Association (ABA) agreed that foreign banks and the non-banking sector forced the banks to 'accept reduced margins and to roll out new technology and new products, and to otherwise respond to competitive pressures.'[10]

2.19 Collins Securities noted the reduction in margins on home lending indicating that the increased competitive pressure of the non-banking sector drove margins down from about 5 per cent to about 1.5 per cent prior to the global credit crisis.[11]

2.20 The advent of the credit crisis has also placed additional pressure on lending margins for both the banking and non-banking sector. Not being able to raise any funding, most of the non-banking sector effectively ceased originating new loans.[12]

2.21 The ABA and the Commonwealth Bank have both asserted that lending margins have continued to decrease. The ABA stated that 'even though variable housing interest rates have increased in absolute terms above Reserve Bank cash rate increases, the actual margin experienced by the banks has continued to decline.'[13]

2.22 The Commonwealth Bank highlighted that its margins will continue to decrease in the current financial climate stating:

> The margins we are making on home loans now…are less than they were a year ago by nearly 10 per cent, and, if you look at the long term funding impacts as money rolls off, you will see that it will continue to decline over the next year because of the funding issue we have got.[14]

2.23 As noted by the Treasury, just after the credit crisis hit, banks independently raised their interest rates by 50 to 60 basis points more than the increases in the RBA's cash rate.[15]

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10 Australian Bankers' Association, *Submission no. 26*, p. 4.
11 Mr R Emmett, Collins Securities Pty Ltd, *Transcript*, 8 August 2008, p. 28.
12 Mr M Rowland, ANZ, *Transcript*, 8 August 2008, p. 37.
13 Mr D Bell, Australian Bankers' Association, *Transcript*, 25 September 2008, p.3.
14 Mr J Sheffield, Commonwealth Bank, *Transcript*, 25 September 2008, p.5.
15 Treasury, *Submission no. 32*, p. 9.

2.24 Between September and November 2008, the RBA board decided to lower the official cash rate by 200 basis points.[16] Also during that time, the banks lowered their interest rates by at least 160 basis points.[17]

2.25 However, the banks have yet to lower their interest rates by the 50 to 60 basis points which they raised independently of the RBA's cash rate.

2.26 This could be an indication that banks are not under any competitive pressure and therefore are not lowering their margins. The MFAA noted that 'if there were more funds and therefore more players in the market there may well have been downward pressure on that [interest rates].'[18]

2.27 The alternate view, put forward by the ABA, is that bank margins have reduced due to the higher funding costs in the short and long term wholesale markets. The ABA stated:

> …the cost of short- and long-term wholesale funding, which accounts for about half of all bank funding, has spiked again. This will be putting margin pressures on the banks.[19]

2.28 According to financial services research firm, CANNEX, the number of products available to consumers in Australia currently has dropped with over 140 financial institutions offering over 1,750 products.[20]

2.29 Near the height of the non-banking sectors rise in the mortgage market, CANNEX noted that Australia had over 150 financial institutions offering over 2,300 home loan products.[21]

2.30 However, while the number of products available has dropped, the RBA indicated that 'the variety and flexibility of mortgage products offered in Australia is high by international standards.'[22]

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16 Reserve Bank of Australia, *Media Release*, 2 September 2008, 7 October 2008 and 4 November 2008.

17 See Table 2.1.

18 Mr P Naylor, Mortgage and Finance Association of Australia, *Transcript*, 14 August 2008, p. 44.

19 Mr D Bell, Australian Bankers' Association, *Transcript*, 25 September 2008, p. 3.

20 CANNEX Mortgage Star Ratings, Report No. 22, September 2008.

21 CANNEX Mortgage Star Ratings, Report No. 20, March 2007.

22 Reserve Bank of Australia, *Submission no. 12*, p. 1.

2.31 JP Morgan was of the view that the variety of products is limited, stating 'the products of most financial services are very generic in nature and are easy to replicate.'[23]

The US sub-prime mortgage crisis

2.32 The collapse of the sub-prime mortgage market in the United States (US) had, and continues to have, wide ranging economic effects both for the US and the global economy.

2.33 It led to the effective closure of the securitisation market and the collapse of some of the world's largest investment firms and banks and is threatening to push both the US and other major advanced economic countries into recession.

2.34 There was a combination of factors that ultimately caused the collapse which will be discussed below.

The US mortgage and housing market – what went wrong?

2.35 In 2003, the US economy was doing very well: jobs were readily available; productivity grew steadily; inflation was low; and interest rates dropped to record lows that had not been seen in 40 years. With an increased household income, consumers purchased houses which in turn stimulated the housing construction industry and housing prices increased in value.

2.36 With low interest rates and a booming economy, mortgage brokers, believing that housing prices would always increase in value, provided housing loans on behalf of banks and other lenders to customers who would not normally be granted a home loan. The RBA noted in its March 2007 Financial Stability Review (FSR) that 'sub-prime loans' are:

> …typically loans made to borrowers with impaired credit histories, which might include one or more payment defaults, a previous loan foreclosure, or bankruptcy. Because of their higher risk of default, sub-prime borrowers are charged higher interest rates than prime borrowers.[24]

23 Mr B Johnson, JP Morgan, *Transcript*, 14 August 2008, p. 20.

24 Reserve Bank of Australia, *Financial Stability Review*, March 2007, p. 23.

2.37 The RBA also noted that 'there has been rapid growth in US sub-prime lending since 2003, with these loans accounting for around one fifth of mortgage originations in 2006 and an estimated 15 per cent of all outstanding mortgages.'[25]

2.38 The lenders sold their sub-prime mortgages to aggregators (eg. investment banks). Selling mortgages allowed the lenders to raise more funds to provide additional loans to satisfy the increased demand.

2.39 The investment bank acquired mortgages from a range of lenders and then bundled them into securities to be sold to a range of wholesale investors including insurance companies, banks, pension and superannuation funds, both local and federal governments and international investors.

2.40 Investment banks raise money by selling securities like mortgage backed securities to investors. Investors get a return based on the quality of the securities. Senior tranches[26] have a low interest rate, while lower tranches have a higher interest rate and thus have a much better return for the investor because they are considered a greater risk.

2.41 The RBA also noted in its 2007 FSR that 'around three quarters of sub-prime loans made since 2003 were repackaged into residential mortgage-backed securities (RMBS) and sold to investors attracted by the higher returns on offer.'[27]

2.42 Mortgage and bond insurers provided insurance that helped the securities to obtain AAA ratings. The ratings given helped encourage the uptake of these instruments. However, there were questions raised about the credit rating agencies' role given they were paid by the investment banks whose securities they were rating.

2.43 Some financial institutions used separate entities called Special Purpose Vehicles (SPV) to take securitised assets off their balance sheets and avoid particular capital requirements.

2.44 In its March 2007 FSR the RBA highlighted that 'a combination of slower growth in house prices, rising mortgage rates, lax underwriting standards, and the expiration of introductory discount

25 Reserve Bank of Australia, *Financial Stability Review*, March 2007, p. 23.

26 A tranche is a portion of one of several related securities that have different risks, rewards and/or maturities.

27 Reserve Bank of Australia, *Financial Stability Review*, March 2007, p. 23.

rates on loans originated in the past few years has resulted in a sharp increase in delinquencies among sub-prime ARMs [adjustable-rate mortgages] in the United States.'[28]

2.45 The rise in interest rates put pressure on home owners that held a sub-prime loan to meet their repayments. The RBA noted:

> It has not been uncommon recently for the repayments of some sub-prime borrowers to rise by 50 per cent or more following the expiration of the introductory interest rate period.[29]

2.46 Unable to meet their repayments on a house that was now valued less than their loan, many home owners defaulted on their loan. In its March 2008 FSR, the RBA noted:

> Recent falls in house prices have also contributed to mortgage defaults as many borrowers that took out loans with little or no down payment now have negative equity. According to the S&P/Case-Shiller index, average house prices in the 20 large US cities covered by the index have fallen by about 10 per cent from their peak in mid 2006, with the pace of decline accelerating in the second half of 2007.[30]

2.47 The substantial increase in defaults on sub-prime mortgages subsequently placed many sub-prime lenders under substantial financial pressure. The RBA's March 2007 FSR noted:

> The increase in delinquencies on sub-prime loans is causing significant difficulties for many sub-prime lenders. A number have been forced to repurchase bad loans that they had earlier sold because of conditions attached to early default. Some are also facing funding pressures and are having difficulties renewing their credit lines. Reflecting this, more than 20 sub-prime lenders have shut down and, on average, the share prices of the largest sub-prime lenders in the United States have fallen by nearly 40 per cent since the start of the year.[31]

2.48 The problems in the sub-prime market eventually spilled over to the wider financial sector. The RBA highlighted that investment banks

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28 Reserve Bank of Australia, *Financial Stability Review*, March 2007, p. 23.

29 Reserve Bank of Australia, *Financial Stability Review*, March 2007, p. 23.

30 Reserve Bank of Australia, *Financial Stability Review*, March 2008, p. 9.

31 Reserve Bank of Australia, *Financial Stability Review*, March 2007, p. 24.

were particularly exposed 'to this market either through the lines of credit they have extended to sub-prime lenders, their own sub-prime lending operations or through their role as aggregators, in which they acquire sub-prime loans from originators for eventual resale as RMBS.'[32]

2.49 Investors in sub-prime residential mortgage-backed securities also experienced losses 'as a result of the increase in sub-prime delinquencies.'[33]

2.50 Credit ratings agencies eventually downgraded some of the securities and the insurance companies increased the cost of insuring against the default risk on sub-prime RMBS.

2.51 There was some uncertainty regarding which institutions had significant sub-prime exposures. This affected confidence in wholesale lending markets, with financial institutions becoming hesitant to lend to one another. These difficulties in accessing funding put pressure on some institutions' liquidity position.

2.52 This sequence of events eventually resulted in the collapse of the US sub-prime mortgage market, the closure of a few sub-prime lenders, investment banks and insurance companies[34] which prompted the US Government to:

> assist with the sale of the investment bank Bear Stearns; place the government sponsored housing enterprises, Fannie Mae and Freddie Mac, under conservatorship; and provide the world's largest insurer, American International Group, with a secured line of credit up to US$85 billion. More recently, the authorities have announced several major initiatives intended to provide a comprehensive approach to relieving systemic stress in the financial system. These initiatives include a plan to purchase up to US$700 billion of troubled assets from banks with significant operations in the United States, and insurance arrangements for short-term money market funds.[35]

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32 Reserve Bank of Australia, *Financial Stability Review*, March 2007, p. 24.

33 Reserve Bank of Australia, *Financial Stability Review*, March 2007, p. 24.

34 Reserve Bank of Australia, *Financial Stability Review*, September 2008, p. 3.

35 Reserve Bank of Australia, *Financial Stability Review*, September 2008, p. 3.

The global impact of the US sub-prime mortgage crisis

2.53 Within the US, the rapid expansion and collapse of the sub-prime mortgage market had wide ranging effects including:

- home owners unable to pay the mortgage lost their homes and will most likely be unable to purchase another one in the future;
- lenders found it difficult to access funding for new loans and some lost a substantial amount investing in securities which ultimately led to closures and takeovers (eg. Washington Mutual and IndyMac);
- investment banks lost a huge amount of capital, well into the billions, and also found it difficult to obtain funding which also resulted in closures and takeovers (eg. Lehman Brothers and Bear Stearns);
- some insurance companies, unable to cover their exposures to the securities, filed for bankruptcy; and
- ratings agencies' reputations, as objective assessors of risk, were severely damaged.

2.54 The collapse of the sub-prime mortgage market in the US also affected a number of international financial markets.

2.55 In particular, banks in the United Kingdom (UK) and Europe have been affected either because of significant investments in the US mortgage backed securities market, or because they have been unable to access sufficient funding in wholesale markets. Some examples include:

- UK banks Northern Rock and Bradford & Bingley, which are under temporary government ownership;
- French investment bank, BNP Paribas, which suspended three of its funds; and
- German regional bank, Sachsen Landes-bank, which was bought out.

2.56 The credit crisis has also had far reaching consequences across the global economy including:

- consumers, whose confidence has been shaken by the events, have reduced their spending;

- investors are much more risk averse than before and are also getting lower returns; and
- lenders are having difficulty accessing funding, which in turn may restrict their ability to undertake new lending.

2.57 The collapse of the sub-prime mortgage market in the US and the resulting disruptions to wholesale funding markets has ultimately led to governments around the world taking the unprecedented step of guaranteeing the stability of their respective financial institutions. Governments and central banks have also taken steps to improve access to liquidity within the market.

Competition post August 2007

2.58 Obtaining access to funding after the commencement of the credit crisis in August 2007 has been extremely difficult. Financial institutions that have a diversified funding base have been a little more protected from the current market conditions, but no institution has been totally immune from the impact of the credit crisis.

2.59 While it is true that there has been a decline in the number of players within the mortgage market, there is some disagreement as to whether this has reduced competition.

2.60 The ANZ noted that the credit crisis has had an impact but believes that competition is still strong, noting that 'intense competition on rate, service and loan features remains prevalent in the market, particularly amongst the major banks.'[36]

2.61 Westpac agrees with the ANZ's view that competition between players is still healthy, noting that 'between the organisations that are out there and competing, competition is very fierce, and we see it on a day-to-day basis.'[37]

2.62 The ABA also believes that competition is strong, especially in the areas of deposits and loans stating:

> Competition in the deposit market is currently very intense as banks and other deposit-takers compete to win deposits as a

36 ANZ, *Submission no. 28*, p. 3.

37 Mr K Lawrence, Westpac Banking Corporation, *Transcript*, 14 August 2008, p. 87.

> means of diversifying their deposit base away from reliance on international capital markets.
>
> Loan markets are similarly highly competitive, with little evidence that the relative decline – albeit temporary - of non-bank lenders in the housing mortgage market will materially increase lending margins.[38]

2.63 The RBA believes that while banks have increased their market share they 'do not think you could say that there has been a marked reduction in competition at the moment'.[39]

2.64 However, the Bank of Western Australia's (BankWest) view is that competition has decreased stating:

> We put it [a reduction in competition] down to three things. Firstly and obviously, there are the funding issues that have become clear over the last nine to 12 months. They have put a number of people with different business models out of the market. Secondly, there is consolidation. Obviously, with the merger of Westpac and St George that has taken another step up. That is causing reduced competition and, in our view, is likely to be exacerbated over the coming several years. Finally, we think there are a number of barriers to entry, in particular in terms of having ATM networks post the reform that is going to go through next year. There is also the need to have store presence in order to compete effectively. We think that concerns a significant barrier to entry.[40]

2.65 The Council of Mortgage Lenders had a similar view stating:

> …with possible consolidation in the banking sector and the impact of the US prime crisis reducing the number of non-banks, there is a serious risk that there will be substantial lessening of competition. For the foreseeable future, this will result in higher mortgage costs to the borrowers because of a lack of competitive pressure on the banks. This will reverse the interest rates spread benefit that the non-banks were able to provide when they became a force in the Australian market in the early nineties. This is very evident already with reports

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38 Australian Bankers' Association, Submission no. 26, p. 1.

39 Mr R Battellino, Reserve Bank of Australia, *Transcript*, 14 August 2008, p. 14.

40 Mr I Corfield, Bank of Western Australia Ltd, *Transcript*, 8 August 2008, pp. 49-50.

> coming out that the margins have fallen at least four basis points in the last four months.[41]

2.66 Competitive pressure has been one of the driving forces lowering margins. However, as noted above, funding pressures have now placed an additional strain on margins.

2.67 The general view from the RBA is that 'when conditions settle down and the cost of funds in the money markets returns to a more normal level, that downward pressure and competition from the non-banks will reappear.'[42]

The current state of the non-banking sector

2.68 The non-banking sector, which has primarily relied on securitisation as a means of funding, has been the hardest hit and, as noted above, there has definitely been a reduction in the amount of providers and products in the mortgage market.

2.69 There is evidence that some non-bank lenders have been bought out by their competitors, stopped selling new mortgages, or slightly changed their focus.[43]

2.70 There are currently two points of view on how the non-banking sector is managing the current financial turmoil.

2.71 Overall, representatives from the sector acknowledge that due to these funding difficulties it has been hard for them to remain in business, let alone staying competitive.

2.72 Collins Securities noted that 'at the moment, we are seeing a lot of non-bank lenders exit the market.'[44]

2.73 The MFAA were concerned that the current credit crisis would result in the non-banking sector being removed from the industry.[45]

2.74 Aussie Home Loans agreed that a number of non-bank players had been wiped out but that 'a number of players will survive—who are strong enough to do that.'[46]

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41 Mr P James, Council of Mortgage Lenders, *Transcript*, 14 August 2008, p. 73.

42 Mr R Battellino, Reserve Bank of Australia, *Transcript*, 14 August 2008, p. 15.

43 Mr C Joye, Centre for Ideas and the Economy, *Transcript*, 21 August 2008, p. 62.

44 Mr R Emmett, Collins Securities Pty Ltd, *Transcript*, 8 August 2008, p. 31.

45 Mr P Naylor, The Mortgage and Finance Association of Australia, *Transcript*, 14 August 2008, p. 43.

46 Mr J Symond, Aussie Home Loans, *Transcript*, 14 August 2008, p. 53.

2.75 The ANZ also noted that the difficulties faced by the non banking sector stating that 'non-bank lenders who relied primarily on securitisation to fund their portfolio have found, since the onset of the global credit crisis, that they have had to materially reduce their new lending.'[47]

2.76 The view from the RBA is that while the non-banking sector has lost its market share, it will regain it as soon as the financial markets normalise.[48]

2.77 The ANZ agreed with the RBA's view stating 'once these [wholesale] costs have fallen and securitisation markets reopen, we expect that these non-bank lenders will return to the securitisation market which will provide them with the funding volume to return to their previous competitive position.'[49]

2.78 Fujitsu Consulting believes that while the non-banking sector has a place in Australia 'it will probably never be as it was, and they probably will be more bit part players than they were previously.'[50]

2.79 The Treasury also notes that the exceptionally narrow spreads of recent years is unlikely to be a feature of the RMBS market for some time to come as investors are likely to demand a more sustainable level of pricing for risk.[51]

Competitiveness of the 'big four'

2.80 The Commonwealth Bank, the Westpac Banking Corporation, ANZ, and the National Australia Bank, are collectively known as the 'big four'.

2.81 While the big four have faced similar funding pressures, their diversified funding base has placed them in a better position than the non-banking sector.[52] As a result, the big four have been able to offer lower interest rates than the non-banking sector.

2.82 Collins Securities noted the lower rates offered by the banks stating:

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47 Mr M Rowland, ANZ, *Transcript*, 8 August 2008, p. 37.

48 Treasury, *Submission no. 32*, p. 1.

49 ANZ, *Submission no. 28*, p. 8.

50 Mr M North, Fujitsu Consulting, *Transcript*, 15 August 2008, p. 25.

51 Treasury, *Submission no. 32*, p. 10.

52 Mr M Rowland, ANZ, *Transcript*, 8 August 2008, p. 37.

> Banks have passed on approximately 0.7 per cent of that increase over and above the Reserve Bank increases in interest rates. Most of the banks are already on the record as saying this. It is probably fair to say that new lending generated by all majors is at a rate of approximately nine per cent. The new lending rates that are occurring in the market at the moment are well below the standard variable rates that are published. Those rates are probably well below the wholesale costs that a non-bank lender can raise their funds on at the moment.[53]

2.83 As banks have been able to source funding from wholesale markets more easily, they have placed competitive pressure on their competitors. As the banks have been able to offer more competitive interest rates in the current environment, the big four have regained the market share that they lost to the non-banking sector over the past decade. From April 2007 to April 2008 the banking sector increased its share from 79.5 per cent to 88.5 per cent.[54]

2.84 While there is no doubt that the big four aggressively compete with the other players in the market, including foreign-owned banks, the credit unions, building societies and the non-banking sector, there is some uncertainty as to whether the big four are actively competing with each other.

2.85 Fujitsu Consulting noted that the big four 'are protected because they are working intrinsically together. It is not formal, but they do look at each other. They compare each other's rates and products.'[55]

2.86 This can be highlighted by the fact that when one of the four either raises or reduces their interest rates, the other three follow very closely and generally within a week.

2.87 Table 2.1 illustrates how the big four have changed their variable mortgage interest rates over the past year. With the exception of April, the big four have put out media releases announcing a change in their variable mortgage interest rates within 4 days of each other. The interest rate change is only within 7 basis points of each other at the most.

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53 Mr R Emmett, Collins Securities Pty Ltd, *Transcript*, 8 August 2008, pp. 28-29.

54 Mortgage and Finance Association of Australia, *Submission no. 4*, p. 8.

55 Mr M North, Fujitsu Consulting, *Transcript*, 15 August 2008, p. 23.

Table 2.1 Comparison of the big four's variable mortgage interest rate for 2008

ANZ		CBA		WBC		NAB	
Date	*% Change*	*Date*	*% Change*	*Date*	*% Change*	*Date*	*% Change*
5/11/08	- 0.58	4/11/08	- 0.58	5/11/08	- 0.65	5/11/08	- 0.62
17/10/08	- 0.25	20/10/08	- 0.21	19/10/08	- 0.20	21/10/08	- 0.20
07/10/08	- 0.80	07/10/08	- 0.80	07/10/08	- 0.80	07/10/08	- 0.80
02/09/08	- 0.25	02/09/08	- 0.25	02/09/08	- 0.25	02/09/08	- 0.25
11/07/08	+ 0.15	11/07/08	+ 0.14	14/07/08	+ 0.15	15/07/08	+ 0.14
24/04/08	+ 0.10	04/04/08	+ 0.12	25/04/08	+ 0.10	28/04/08	+ 0.10
11/03/08	+ 0.35	10/03/08	+ 0.35	06/03/08	+ 0.29	07/03/08	+ 0.30
08/02/08	+ 0.25	06/02/08	+ 0.30	08/02/08	+ 0.29	07/02/08	+ 0.25
08/01/08	+ 0.20	09/01/08	+ 0.10	03/01/08	+ 0.12	11/01/08	+ 0.15

Sources *ANZ 2008 Media Releases, Commonwealth Bank of Australia 2008 Media Releases, Westpac Banking Corporation 2008 Media Releases, National Australia Bank 2008 Media Releases.*

2.88 However, the Treasury noted that 'it is well recognised that competition can exist in markets with a small number of major suppliers, particularly where there is a 'competitive fringe' of smaller players or where barriers to entry and exit are sufficiently low for there to be a credible threat of competition from new entrants.'[56]

The future outlook

2.89 There is evidence to suggest that, up until the recent financial turmoil, competition in the Australian mortgage market was strong and contributed to driving down margins and promoting product innovation.

2.90 Due to the credit crisis, there has been a reduction in the amount of providers in the mortgage market and, as a consequence, there appears to be a reduction in the amount of competitive pressure between players in the market.

2.91 However, given margins are being reduced by external financial pressures, most notably the cost of funding, this would indicate that there is still enough competitive pressure within the market.

2.92 Increased levels of competition will return, but with the current financial climate groups are uncertain of how long it will take and whether it will be as effective as it was prior to 2007.

56 Treasury, *Submission no. 32*, p. 3.

International comparisons

2.93 Each country has its own unique financial sector, regulation, and mortgage market. It is therefore difficult to compare Australia directly with another country.

2.94 However, the credit crisis has demonstrated the robustness and stability of Australia's financial sector.

2.95 This section looks at how Australia's banking sector is viewed globally and the strengths of our financial system.

How does Australia's market compare internationally

2.96 Both Australia's financial system and mortgage market are relatively strong and healthy in comparison with other countries. The International Monetary Fund (IMF) noted that 'house prices fell in the first half of 2008 at an annual rate of 5 per cent to 12 per cent in Canada, Denmark, Spain, New Zealand, and the United Kingdom.'[57] Australia is one of the few countries that have continued to see an increase in housing prices.

2.97 In particular, the IMF *Country Report* on Australia highlighted the strength of Australia's banking system stating:

> Australian banks have weathered the global financial turmoil reasonably well. The four large banks that account for two-thirds of bank assets continued to report strong profits through early 2008, together with adequate capital.[58]

2.98 In addition, Australia's four largest banks have been given a credit rating of AA (very high credit quality) by credit rating agency Standard & Poor's. The RBA noted that 'of the world's largest 100 banks, only a handful have higher ratings' and that 'no Australian-owned bank has had its rating downgraded since the onset of the credit turmoil.' [59]

2.99 The strong credit rating has enabled the banks to access both domestic and international capital markets. Compared with the US and UK, Australia's mortgage market continues to function effectively.

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57 International Monetary Fund, *World Economic Outlook, October 2008, Financial Stress, Downturns, and Recoveries,* p. 16.

58 International Monetary Fund, *IMF Country Report No. 08/312*, September 2008, p. 8.

59 Reserve Bank of Australia, *Financial Stability Review*, September 2008, p. 35.

2.100 The market is also relatively concentrated in comparison with some other countries. The Treasury noted that 'Australia's five largest banks account for the majority of market share.'[60]

2.101 The entire banking sector has consolidated to some extent since 2000 with 'the number of building societies falling from 19 to 13 between March 2000 and March 2007, and the number of credit unions from 218 to 137 over the same period.'[61]

2.102 Both the banking and non-banking sectors have made prudent decisions about international investments and home loans.[62] The sectors have had a relatively small exposure to US sub-prime assets and were therefore not as vulnerable as other countries to the credit crisis, particularly in Europe.

2.103 The RBA noted in its September 2008 Financial Stability Review that:

> US exposures account for less than 10 per cent of Australian-owned banks' total foreign claims, and typically do not arise through lending to the US household sector. While some banks have reported that they have exposures to the US sub-prime market through holdings of financial instruments, these remain small when compared to the size of these banks' balance sheets.[63]

2.104 In comparison, the Bank of Canada noted in its June Financial System Review that:

> Overall, the direct exposure of Canadian banks to the United States represents about 16 per cent of total bank assets, more than the combined exposure to any other group of foreign countries.[64]

2.105 Australia's banking and non-banking sectors have also not engaged actively in selling 'non-conforming loans' (the closest equivalent to US sub-prime loans). The RBA also noted that: 'non-conforming loans account for less than one per cent of outstanding mortgages in Australia – compared with about 12 per cent in the United States.'[65]

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60 Treasury, *Submission no. 32*, p. 3.

61 Australian Prudential Regulation Authority, *Submission no. 34*, p. 2.

62 Reserve Bank of Australia, *Financial Stability Review*, September 2008, p. 1.

63 Reserve Bank of Australia, *Financial Stability Review*, September 2008, p. 25.

64 Bank of Canada, *Financial System Review*, June 2008, p. 22.

65 Reserve Bank of Australia, *Financial Stability Review*, September 2008, pp. 24-25.

2.106 There are certainly a significant amount of Australian households that have been put under severe stress as a result of the rise in interest rates. However, compared internationally, Australia has low arrears rates on housing loans. The RBA noted: 'the overall arrears rates on housing loans has shown little change over the past year, and remains low by historical and international standards.'[66]

2.107 The 90 day arrears rate for prime housing loans for Australian banks is 0.41 per cent in contrast to the UK's prime loans which are 2.9 per cent and the US on prime loans which is just below 5 per cent and sub-prime loans which is around 21 per cent.[67] The arrears rates in Canada are also at low levels with prime loans just above 0.2 per cent and sub-prime loans at around 1.5 per cent.[68]

2.108 However, Australia's banking sector tends to have higher account keeping fees and higher administration and management fees compared with other countries.

2.109 Fujitsu Consulting indicated that Australian banks were inefficient by international standards noting that 'the average cost of a mortgage in Australia to write for the banks is around 30 per cent to 35 per cent higher than best practice in the UK or the US.'[69]

2.110 Fujitsu Consulting added that on average 'sixty per cent of loans require some reiteration between the application and writing the loan' and that 'in the UK it is five per cent.'[70]

2.111 A report prepared for the British Bankers' Association, *The Price of Banking, An international comparison*, highlighted that both the account keeping fees and administration and management fees were higher in Australia than the other countries selected for the study including Canada, the US and the UK.[71]

2.112 The report also indicated that the disclosure of information by the banks was not entirely transparent, stating:

> While most fees are disclosed by all of the Australian Banks covered in this study, the complexity of their products and charging structures is not matched by clear explanations of

66 Reserve Bank of Australia, *Financial Stability Review*, September 2008, p. 2.

67 Reserve Bank of Australia, *Financial Stability Review*, September 2008, pp. 5-6, 44.

68 Bank of Canada, *Financial System Review*, June 2008, p. 31.

69 Mr M North, Fujitsu Consulting, *Transcript*, 15 August 2008, p. 21.

70 Mr M North, Fujitsu Consulting, *Transcript*, 15 August 2008, p. 21.

71 Oxcera Consulting Ltd, *The Price of Banking: An international comparison, a report prepared for the British Bankers' Association*, November 2006.

> when certain charges apply. This was found to be the case particularly for current accounts and personal loans, where there were also several significant gaps in the availability of information on charges and interest rates.[72]

2.113 Australia also has a low switching rate compared with other countries. CHOICE noted that 'around three per cent of Australian bank customers change financial institutions annually' and 'that is about half the rate in the UK and well below the European Union average.'[73]

2.114 It is clear that while Australia's financial sector has not been as exposed to the US sub-prime mortgage crisis as other countries, the decline and increased costs in available funding has affected the market. On the whole, the Australian market is coping well in the current financial conditions.

The key strengths of the Australian financial system

2.115 It is widely considered that Australia has a strong financial system as a result of good regulation and financial institutions making prudent decisions.

2.116 The IMF *Country Report* on Australia noted the robust regulatory environment stating that 'sound macroeconomic policies and structural reforms in Australia have delivered more than 16 years of economic expansion'.[74]

2.117 The IMF also noted that 'the RBA responded promptly and fittingly to the domestic impact of the global financial market turmoil' and 'the Australian Prudential Regulation Authority (APRA) also reacted in a timely and appropriate manner.'[75]

2.118 The other key strength is that both the banking and non-banking sector have been making prudent financial decisions. As indicated above, this is evident by the low amount of non-conforming loans within the market, the limited direct exposure to the US sub-prime mortgage market, and the banks' healthy balance sheets.

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72 Oxcera Consulting Ltd, *The Price of Banking: An international comparison, a report prepared for the British Bankers' Association*, November 2006, p. 61.

73 Ms E Freeman, CHOICE, *Transcript*, 21 August 2008, p. 75.

74 International Monetary Fund, *IMF Country Report No. 08/312*, September 2008, p. 6.

75 International Monetary Fund, *IMF Country Report No. 08/312*, September 2008, p. 19.

2.119 Good management by both government and businesses have put Australia in a relatively stable financial position globally.

3

Options to increase competition

Introduction

3.1 Healthy competition is a key driver for the economy. Competition in the banking and non-banking sectors provides advantages to the consumer, with lower interest rates and fees, to businesses and shareholders, with considerable profits and returns, and to the economy with increased productivity and jobs.

3.2 Competition takes many forms and can be influenced by a number of wide ranging factors. In the past 20 – 30 years competition within the sector has been increased due to: financial deregulation; foreign-owned banks and non-bank lenders entering the market; securitisation; and innovations that directly benefited the customer such as phone and internet banking and mobile mortgage lenders.

3.3 This chapter examines the current state of competition and proposals set before the inquiry on how competition can be enhanced further.

Trends in the cost of funding

3.4 Financial institutions obtain funding to lend to home buyers from a range of sources including deposits, domestic and foreign capital markets and securitisation.

3.5 The RBA noted that different financial institutions obtained funding from different sources, stating:

> The five largest banks have diversified funding bases, with a little under half of total funding coming from deposits, around half from domestic and foreign capital markets, and only about 5 per cent from securitisation. The foreign-owned banks have traditionally relied less on deposits, and more heavily on domestic capital markets and offshore funding. As a group, the regional banks rely more heavily on securitisation than the other banks, although deposits still account for the largest share of their funding. Mortgage originators source essentially all of their funding from securitisation, as typically they have neither the balance-sheet size nor the capital base from which loans could be provided.[1]

3.6 The importance of deposit funding for banks has declined over time as deposit growth has not matched lending growth. Until recently the proportion of household assets deposited in bank accounts has been declining. Groups have argued that the decline in deposits could be for two reasons: reduced savings levels and increased savings in superannuation funds.

3.7 Abacus Australian Mutuals noted the decline in deposits stating:

> ADIs [Authorised Deposit Taking Institutions] are competing over a pool of deposits—as an important source of funding for home loans—that is shrinking. From a peak of more than 30 per cent of household financial assets in December 1990, deposits now account for less than 19 per cent.[2]

3.8 Resi Mortgage Corporation noted that 'relying predominantly on customer deposits for mortgage funding is a method which has become largely redundant' and that 'over the last twenty years the use of consumer credit has increased and Australian savings levels have declined.'[3]

3.9 The National Australia Bank indicated that due to an increased demand for credit, Australian banks have had to source more funding from offshore and that 'consumer deposits have been dwindling as a source of bank funding since the introduction of compulsory superannuation in 1992.'[4]

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1 Reserve Bank of Australia, *Submission no. 12*, pp. 4-5.

2 Ms L Petschler, Abacus Australian Mutuals, *Transcript*, 21 August 2008, p. 4.

3 Resi Mortgage Corporation Pty Limited, *Submission no. 20*, p. 9.

4 Mr S Shaw, National Australia Bank, *Transcript*, 19 September 2008, p. 2.

3.10 The Australian Securitisation Forum (ASF) also believes that superannuation has had an effect on the level of deposits stating 'the growth of the superannuation sector has outpaced that in the deposit sector over the last decade or so, and savings that used to be directed into retail deposits and hence be a source of mortgages are now flowing more into the superannuation sector.'[5]

3.11 The cost of funding in both the domestic and foreign capital markets as well as via securitisation has increased substantially due to the credit crisis.

3.12 The RBA highlighted the difference in cost for residential mortgage-backed securities (RMBS) prior to and during the credit crisis:

> …prior to the recent turmoil, the spread on the AAA-rated tranche of residential mortgage-backed securities had fallen to around 15 basis points, compared to 34 basis points in 2000.
>
> Since August 2007, spreads on RMBS have increased markedly and issuance has been limited. Where issues have taken place, they have recently been at spreads of around 120 basis points over the bank bill rate.[6]

3.13 Collins Securities also pointed out the increased cost of securitisation within the last 12 months stating that 'the total cost of securitisation has probably increased by about 1.6 per cent [160 basis points].'[7]

3.14 It is clear overall that in recent times, financial institutions have found it increasingly difficult to access funding in wholesale markets, and where they have continued to be able to do so this has been at an increased cost.

The state of the securitisation market

3.15 Securitisation is a relatively new innovation within the mortgage market. It originally started in the United States (US) in the 1970s. Securitisation started in Australia in the mid 1980s when it became used as source of funding by state governments to finance public

5 Mr P Vernon, Australian Securitisation Forum, *Transcript*, 15 August 2008, p. 37.
6 Reserve Bank of Australia, *Submission no. 12*, pp. 3-4.
7 Mr R Emmett, Collins Securities Pty Ltd, *Transcript*, 8 August 2008, p. 35.

housing loan schemes. In the early 1990s, securitisation enabled the non-banking sector to enter the mortgage market.[8]

3.16 The Centre for Ideas and the Economy (CITE) noted the positive change that securitisation had on the mortgage market stating:

> The advent of residential mortgage-backed securities securitisation in Australia during the mid 1990s transformed the mortgage market by intensifying competition to the demonstrable benefit of households. For example, the 'spread' between the interest rates paid by borrowers and the bank bill rate fell from around 4% in 1992 to about 1.4% prior to…August 2007.[9]

3.17 In the last 12 months the securitisation market has come to a standstill because of the fallout from the US sub-prime mortgage crisis.

3.18 The Rock Building Society highlighted that point stating 'the one major change that has happened in recent times is that that market is not functioning and has not been functioning effectively since August last year.'[10]

3.19 The Rock Building Society also noted that:

> Late last year…one of the international banks, Societe Generale, pulled out of the securitisation market. They were a provider of…$12 billion of warehouse funding to financial institutions in Australia….all of those financial institutions had to then go and try to find alternative warehouse funding from the major banks in Australia.[11]

3.20 CITE also noted the effective closure of the securitisation market stating, 'in Australia there have been virtually no public securitisations of AAA-rated home loans since November 2007.'[12]

3.21 The Australian Government recognised the credit crisis had affected the economy more substantially than previous indications and in particular that there was a shortfall in liquidity within the mortgage market. As a consequence, the government announced a number of

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8 A Liaw and G Eastwood, Australian Prudential Regulation Authority, *The Australian Securitisation Market, working paper 6*, October 2000.

9 Centre for Ideas and the Economy, *Submission no. 1*, pp. 3-4.

10 Mr D Lightfoot, The Rock Building Society, *Transcript*, 8 August 2008, p. 3.

11 Mr D Lightfoot, The Rock Building Society, *Transcript*, 8 August 2008, p. 3.

12 Mr C Joye, Centre for Ideas and the Economy, *Transcript*, 21 August 2008, p. 61.

initiatives designed to add both confidence and liquidity to the market.[13]

3.22 On 3 October 2008, the Treasurer announced that he had directed the Australian Office of Financial Management (AOFM) to invest $4 billion in Australian RMBS. The $4 billion in funding is allocated to both the banking and non-banking sectors.[14]

3.23 On 12 October 2008, the government also announced that the AOFM would add an additional $4 billion in funding for the purchase of RMBS for Australian non-ADI lenders. This additional $4 billion has been allocated directly to the non-banking sector (lenders who are not banks, building societies or credit unions).[15]

3.24 The additional $8 billion in funding is going to be allocated over a period of 3 years.[16]

3.25 The Prime Minister stated that the additional funds benefit Australia's mortgage market and ensure that this sector of the lending market has access to funding for its operations.[17]

Will securitisation return to its pre 2007 levels

3.26 The damage that the credit crisis has caused to the global financial system is considerable. Governments around the world have taken unprecedented steps to guarantee their banks and other financial institutions to ensure stability.

3.27 Investors, understandably, do not want to take any unnecessary risks in the current climate and are therefore extremely cautious before making any decision about re-entering the market.

3.28 The financial market is cyclical in nature. It will go up and down from time to time. However, as noted by the Treasury, 'once some normality returns to the market, this will assist in stimulating demand for RMBS and restore this funding channel.'[18]

3.29 It is uncertain at this stage of how long this particular downturn in the cycle will take.

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13 Prime Minister of Australia, *Media Release*, *Global Financial Crisis*, 12 October 2008.

14 Treasurer of the Commonwealth of Australia, *Media Release*, *Treasurer Directs the AOFM to Invest in RMBS*, 3 October 2008.

15 Prime Minister of Australia, *Media Release*, *Global Financial Crisis*, 12 October 2008.

16 Prime Minister of Australia, *Media Release*, *Global Financial Crisis*, 12 October 2008.

17 Prime Minister of Australia, *Media Release*, *Global Financial Crisis*, 12 October 2008.

18 Mr J Murphy, Treasury, *Transcript*, 14 August 2008, p. 30.

3.30 It is fair to say that the unique conditions that sparked the last global financial boom are unlikely to reappear again and, as JP Morgan pointed out, 'the credit wrap of ensuring the risk has gone up so much that I do not think securitisation can ever come back to what it was before.'[19]

Does Australia need an 'AussieMac' model

3.31 A lack of access to liquidity within the mortgage market is a key theme that has been raised during the course of this inquiry. There are a number of groups that believe Australia needs an institution with the objective of providing liquidity to Australia's mortgage market over the long term.

3.32 Canada and the US have already established institutions with the objective of providing liquidity to their respective mortgage markets: the Canada Mortgage and Housing Corporation (CMHC) and the Federal National Mortgage Association (Fannie Mae) and Federal Home Loan Mortgage Corporation (Freddie Mac) in the US.

3.33 CITE put forward a proposal that has a similar objective to Canada's Mortgage and Housing Corporation, Fannie Mae and Freddie Mac which they have called 'AussieMac'.[20]

How would an 'AussieMac' model work

3.34 The objective of the CITE proposal is to 'provide a minimum level of back-stop stability to the residential mortgage-backed securities market in Australia.'[21]

3.35 Under CITE's proposal, the Australian Office of Financial Management 'would guarantee the creditworthiness of an…AussieMac, thereby lending it Australia's AAA credit rating.'[22]

3.36 CITE added:

> AussieMac would be able to issue substantial volumes of very low-cost bonds into the domestic and international capital markets. The funds raised by AussieMac through issuing

19 Mr B Johnson, JP Morgan, *Transcript*, 14 August 2008, p. 25.

20 Centre for Ideas and the Economy, *Submission no. 1*, p. 6.

21 Centre for Ideas and the Economy, *Submission no. 1*, p. 1.

22 Centre for Ideas and the Economy, *Submission no. 1*, p. 8.

these bonds could be used to acquire high-quality AAA-rated Australian home loans off the balance-sheets of lenders.[23]

3.37 CITE also noted that 'AussieMac would not be able to fund low-quality or 'sub-prime' loans: lenders would have to satisfy AussieMac's strict, pre-determined credit criteria before their loans would be eligible for acquisition.'[24]

3.38 CITE recommended that the amount of liquidity an 'AussieMac' model could supply during the course of everyday market operations be limited and that 'these constraints would be relaxed only during times of extreme illiquidity, or total market failure, when 'AussieMac' model would be able to step into the breach and act to normalise demand and supply.'[25]

3.39 Better Mortgage Management indicated that an 'AussieMac' model 'would allow non-banks to continue writing new business at rates competitive with the banks.'[26]

3.40 Others, like ANZ agreed that 'the proposal would provide additional liquidity to the market and assist those non-bank lenders reliant on securitisation'.[27]

3.41 In conclusion, however, the ANZ questioned whether this type of intervention in the market is necessary. Similarly, the CBA stated that the 'creation of an AussieMac would be premature'.[28]

The US and Canadian experience

3.42 Fannie Mae was established in 1938 towards the end of the great depression in the US. Up until 1968, Fannie Mae held a monopoly over the secondary mortgage market (the market where mortgage backed securities or bonds are sold). The US privatised Fannie Mae in 1968 and established Freddie Mac, also as a private entity, in 1970 as a direct competitor to Fannie Mae within the secondary mortgage market.

3.43 Fannie and Freddie do not supply home loans directly to consumers. They ensure that financial institutions have enough funds to lend to

23 Centre for Ideas and the Economy, *Submission no. 1*, p. 8.
24 Centre for Ideas and the Economy, *Submission no. 1*, p. 8.
25 Centre for Ideas and the Economy, *Submission no. 1*, p. 8.
26 Better Mortgage Management Pty Ltd, *Submission no. 6*, p. 2.
27 ANZ, *Submission no. 28*, p. 8.
28 Commonwealth Bank of Australia, *Submission no. 27*, p. 3.

home buyers. They do this by purchasing mortgages from a lender. The purchase of a mortgage by Fannie or Freddie enables the lender to make new loans for other customers to borrow. The mortgages are packaged into mortgage backed securities which are then sold to investors. This in turn provides Fannie and Freddie the funds to purchase more mortgages.

3.44 The sub-prime mortgage crisis in the US put both Fannie and Freddie under substantial financial pressure as they were unable to raise any new funds to purchase mortgages. An inability to raise the necessary capital to continue operations put both institutions' long term viability in doubt.

3.45 The US Government determined that the collapse of either institution would cause significant damage to the secondary mortgage market both within the US and internationally and adversely affect the economy as a whole.

3.46 In order to prevent a possible collapse, the US Government placed Fannie and Freddie under their control on 7 September 2008. The US Government gave responsibility for managing the operations of Freddie and Fannie to the Federal Housing Finance Agency (FHFA).

3.47 The other proposed international model, CMHC, was created in 1946 to house returning war veterans and to administer Canada's housing programs.

3.48 The CMHC has a similar objective to Fannie Mae and Freddie Mac, in that it ensures that financial institutions have enough funds to lend to home buyers. However, unlike its counterpart agencies in the US, the CMHC also provides mortgage loan insurance; funding for housing, renovations and repairs; financial consultants; and undertakes research and analysis on the Canadian housing market and housing technologies.

3.49 Canada's mortgage market appears to be healthy in comparison with the US. However, the cost of credit has also risen as Canada's banks have been unwilling to provide funding. In order to add extra liquidity to the market, the Canadian Government has added an additional C$25 billion in insured mortgage pools which will be purchased by the CMHC.

Conclusions

3.50 The committee believes that the 'AussieMac' proposal is not a suitable model for the Australian context.

3.51 The committee supports the move by the government to have the Australian Office of Financial Management (AOFM) allow both ADIs and non-ADIs to purchase $8 billion in RMBS over the next 3 years.[29]

3.52 The committee believes that the actions taken by the government are positive steps toward adding additional liquidity within the market.

3.53 Recent difficulties in the RMBS market, as a consequence of the global financial crisis, have made it difficult for some mortgage providers to actively compete in the mortgage market. As a result, the committee welcomes the government's initiatives to invest $8 billion of RMBS in order to support recovery in the RMBS market.

Recommendation 1

3.54 **The committee recommends that the government continue to monitor the state of the Residential Mortgage-Backed Securities market and review the adequacy of the current level of investment in light of future market developments.**

Reserve Bank of Australia's repurchase agreements

3.55 The committee received evidence on a number of other proposals designed to add short term liquidity to the market including the RBA's repurchase agreements.

3.56 The RBA carries out its open market operations primarily using repurchase agreements (repos) and outright transactions in short-dated government securities. When the RBA purchases securities under repo, it provides cash in return to the counterparty, for a specified term and at a price determined by competitive tender. The securities provide the collateral for the loan, so that in the event that the counterparty is unable to repay the loan, the securities may be

29 Prime Minister of Australia, *Media Release*, 12 October 2008.

sold into the market to recoup the loan proceeds. Because the Bank needs to manage system cash on a day-to-day basis to ensure the cash rate remains at the target, in normal circumstances, repos are for relatively short terms (up to around three months).

3.57 Since the onset of the financial turbulence, term money markets have, on occasions, become quite dysfunctional. In order to alleviate some of these problems, the Bank has sought to extend the term of its repo operations and expand the range of securities that it is willing to accept in its repo operations. Repos are now routinely undertaken for terms of up to one year, and the range of collateral accepted by the Bank extends to virtually any domestic security that has a high credit rating.

The extent of their usage and effectiveness

3.58 From the evidence received, it appears as though there is some confusion between groups as to whether they are able to apply for RBA repos.

3.59 CITE in its submission noted that 'non-bank lenders have never sought relief through the RBA's 'repurchase agreements' because the restrictions the RBA enforces make it next to impossible for them to do so'.[30]

3.60 Likewise, the ASF noted that 'RBA repurchase agreements - has provided short term relief but in its current form is practically inaccessible to non-banks and small financial institutions.'[31]

3.61 It was the understanding of the Credit Ombudsman Service that 'non-bank ADIs do not have exchange settlements accounts with the Reserve Bank.'[32]

3.62 The Rock Building Society also stated that they 'have not really been able to access that [repos] and I think that is a similar story for even some of the regional banks.'[33]

3.63 The RBA has stated that they are more than willing to 'accept whatever amount of mortgage-backed securities anybody is willing to bring' and that 'nobody wants to bring them to us'.[34]

30 Centre for Ideas and the Economy, *Submission no. 1*, p. 14.

31 Australian Securitisation Forum, *Submission no. 30*, p. 28.

32 Mr R Venga, The Credit Ombudsman Service Ltd, *Transcript*, 21 August 2008, p. 42.

33 Mr D Lightfoot, The Rock Building Society, *Transcript*, 8 August 2008, p. 11.

34 Mr R Battellino, Reserve Bank of Australia, *Transcript*, 14 August 2008, p. 8.

3.64 The RBA added that they have a 'repos book of about $50 billion' with 'less than $2 billion of that are mortgage-backed securities.'[35]

3.65 While groups acknowledged that the RBA repos provide short term liquidity to the market, they question its effectiveness in adding liquidity to the market long term.

3.66 The Treasury noted that 'the repo market…is only there for short-term funding needs' and 'to run a proper mortgage business, one has to have some guarantee of reasonably strong lines of funding.'[36]

3.67 The ASF noted that mortgage businesses need long term funding stating: 'wholesale funders need to have the confidence that they can have access effectively to a long-term liquidity backstop.'[37]

3.68 Genworth Financial also endorsed the changes to the repo arrangements but noted the need for a long term solution stating: 'you want to have a long-term framework in place for fundamental lending through all cycles in the housing sector.'[38]

Conclusions

3.69 The mortgage industry is not a short term business with the typical mortgage lasting up to 30 years. Repurchase agreements are available for a maximum of around one year.

3.70 As indicated by the ASF and Genworth Financial, a mortgage business requires access to long term funding. If repurchase agreements were to be used effectively in adding liquidity to the mortgage market over a longer term, the RBA would need to provide certainty of funding for a much longer period than is presently the case.

3.71 A financial institution sells their securities to the RBA for cash in order to gain extra funding.

3.72 There is also a level of risk associated with lending money. Lenders offering long-term mortgages typically need access to long-term funding, or have substantial capital bases which allow them to take on this maturity transformation risk.

35 Mr R Battellino, Reserve Bank of Australia, *Transcript*, 14 August 2008, p. 8.

36 Mr J Murphy, Treasury, *Transcript*, 14 August 2008, p. 30.

37 Mr P Vernon, Australian Securitisation Forum Inc., *Transcript*, 15 August 2008, p. 39.

38 Mr P Hall, Genworth Financial, *Transcript*, 15 August 2008, p. 50.

3.73 JP Morgan noted that:

> There is a suggestion that the central bank can repurchase those securities and hold them indefinitely, but there is a cost. The risk does not disappear.[39]

3.74 The committee supports the steps taken by the RBA to widen the range of securities that it will accept as collateral and to lengthen the term to maturity.

3.75 The RBA repurchase agreements are an effective tool for adding short term liquidity to the market. However, there is still a concern that expanding the repurchase agreements by extending their term to maturity even further may place additional unnecessary risk on the RBA.

3.76 The committee believes that while there is merit in the proposal to make repos a long term funding option, further study on whether this will place additional risk on the RBA needs to be undertaken.

Recommendation 2

3.77 **The committee recommends that the Reserve Bank of Australia examine the appropriateness, feasibility and risks of expanding the repurchase agreements by extending their term to maturity even further and provide a public audit report within six months. The report must be made available to the committee for review.**

Australian Office of Financial Management

3.78 Another option to provide long term liquidity to the mortgage market is for the AOFM to invest in RMBS.

3.79 The AOFM is responsible for issuing government debt, managing the government's cash balances, undertaking investments of financial assets and managing resulting asset and debt portfolios.

39 Mr B Johnson, JP Morgan, *Transcript*, 14 August 2008, p. 21.

3.80 The *Financial Management and Accountability Act 1997* has given the Treasurer the power to invest public money in authorised investments. The Treasurer could direct the AOFM to invest in RMBS long term.

3.81 The AOFM noted that they could, if directed, invest in RMBS:

> The list of investments authorised by the Treasurer includes debt instruments, rated AAA or equivalent by one of the major credit rating agencies, issued by financial institutions in Australian currency…[and] it would potentially cover a high proportion of residential mortgage-backed securities issued by Australian financial institutions.[40]

3.82 The groups that provided evidence to the inquiry were, for the most part, positive that this proposal could provide liquidity to the mortgage market.

3.83 The ASF agreed that the proposal has the potential to aid competition in the long term noting some advantages:

> The advantages of the proposed AOFM initiatives are that liquidity can be provided to the market as needed, it is quick in implementation, increased return on government funds raised to provide a government benchmark, and balancing the supply and demand in the mortgage-backed securities market at a price that creates a level playing field.[41]

3.84 The Challenger Financial Services Group indicated that the AOFM investing in Australian RMBS shows investors that the government is confident that there are limited risks. This could have the wider benefit of creating confidence for both national and international investors in Australian RMBS. They stated:

> The big benefit of acquisition, as opposed to a securities lend style structure, is that I think you can engender and create that situation that we spoke of earlier and start pulling offshore investors in as well. We have examples of that ourselves showing that if you know that AOFM are investing alongside then you can garner a lot more interest.[42]

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40 Mr N Hyden, Australian Office of Financial Management, *Transcript*, 19 September 2008, pp. 32-33.

41 Australian Securitisation Forum, *Submission no. 30*, p. 24.

42 Mr B Benari, Challenger Financial Services Group, *Transcript*, 15 August 2008, p. 88.

3.85 There is always going to be an element of risk associated with any proposal. The AOFM noted that ‘any investment is subject to interest rate risk.’[43]

3.86 In aiding competition within the mortgage market, the AOFM indicated that ‘the size of the investment is clearly a key parameter in determining not only the risk that would be covered for the government but also the effectiveness of the intervention or the impact it would have on the mortgage lending market.’[44]

Covered Bonds

3.87 Covered Bonds were also identified as a possible additional source of liquidity.

3.88 Covered bonds work in a similar way to mortgage-backed securities in that they enable the financial institution to obtain a lower cost of funding in order to grant mortgage loans for housing. The significant difference is that covered bonds are considered to have less risk than mortgage-backed securities.

3.89 Covered bonds are issued directly by the financial institution and therefore remain on the institution’s balance sheet. Bonds are covered by a group, or ‘pool’, of mortgage loans. If the issuing institution collapses, the bonds are ‘covered’ by the pool and are separated from the institution’s other assets to pay back the bond holder.

3.90 The ASF provided an overview of covered bonds within its submission noting that:

> Covered bonds are a widely used funding mechanism in the U.K. and European markets. In some of those jurisdictions, there are statutory schemes that regulate the issue of covered bonds.[45]

3.91 The Treasury noted that in Europe, 15-20 per cent of mortgages are funded by covered bonds.[46] This is also in part due to the fact that

43 Mr N Hyden, Australian Office of Financial Management, *Transcript*, 19 September 2008, p. 34.

44 Mr N Hyden, Australian Office of Financial Management, *Transcript*, 19 September 2008, p. 34.

45 Australian Securitisation Forum, *Submission no. 30*, p. 20.

46 Treasury, *Submission no. 12*, p. 4.

most investments of covered bonds tend to be for periods of around 5-10 years.

3.92 The ASF also highlighted that investment in covered bonds continued to rise 'despite the dislocation in the global credit markets, with issuance up 158%' in the second quarter of 2008.[47]

3.93 The Australian Bankers' Association supported the idea of a covered bond proposal and acknowledged that they could see how the proposal could add liquidity to the market.

3.94 However, it is the Australian Prudential Regulation Authority's (APRA) view that 'covered bonds are not considered to be consistent with depositor preference provisions set out in the Banking Act and hence are prohibited.'[48]

3.95 Section 13A(3) of the *Banking Act 1959* states:

> If an ADI becomes unable to meet its obligations or suspends payment, the assets of the ADI in Australia are to be available to meet that ADI's deposit liabilities in Australia in priority to all other liabilities of the ADI.[49]

3.96 As indicated above, if an institution that has issued a covered bond collapses, the bond is separated from the institution's other assets. Section 13A(3) of the Banking Act effectively means that all assets of the ADI cannot be separated in the event of a collapse. APRA has therefore prohibiting the issue of covered bonds under paragraph 7 of *ADI Prudential Standard APS 120 Securitisation*.[50]

Conclusions

3.97 There is certainly merit in the proposal that ADIs be able to issue covered bonds. However, there is still some uncertainty about how covered bonds would fit within the current financial framework.

3.98 Adding covered bonds as an alternative to raising capital is not something that can be accomplished within a short period of time. Extensive studies would need to be undertaken on how covered bonds would benefit the whole banking and non-banking sector as

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47 Australian Securitisation Forum, *Submission no. 30*, p. 21.

48 Australian Prudential Regulation Authority, *Letter to ADIs: Covered Bonds*, 29 April 2008.

49 This has recently been amended by the *Financial System Legislation (Financial Claims Scheme and Other Measures) Act 2008*. However, deposit liabilities still have priority over other liabilities.

50 Australian Prudential Regulation Authority, *Letter to ADIs: Covered Bonds*, 29 April 2008.

well as how both consumers who invest in covered bonds and depositors in the ADI would be protected.

3.99 If there proved to be a sizeable benefit, then the government would need to consider amending the Banking Act as well as adding an effective regulatory framework.

3.100 The committee believes that further study on how covered bonds would be regulated needs to be undertaken.

Recommendation 3

3.101 **The committee recommends that the Treasury examine the appropriateness and feasibility of allowing Australian authorised deposit-taking institutions to issue covered bonds.**

Bank of England Special Liquidity Scheme

3.102 Countries around the world are experiencing similar financial challenges due to the credit crisis. Most notably the Canadian and US experiences which have been discussed earlier in this chapter.

3.103 The United Kingdom (UK) has not been immune from the effects of the credit crisis either with the UK Government taking temporary public ownership of two banks, Northern Rock and Bradford & Bingley, and acquiring significant shareholdings in Halifax – Bank of Scotland (HBOS), Lloyds Bank and the Trustee Savings Bank (Lloyds TSB) and the Royal Bank of Scotland (RBS).[51]

3.104 The mortgage sector in the UK has had significant difficulty in obtaining access to liquidity. The Bank of England launched a 'Special Liquidity Scheme' designed to improve liquidity within the banking system and boost the confidence of the financial market.

3.105 Under the Special Liquidity Scheme, banks are able to temporarily swap mortgage-backed securities for UK Treasury Bills for a period of

51 HM Treasury, *Press Notice*, Northern Rock plc, 17 February 2008 and HM Treasury, *Press Notice*, Bradford & Bingley plc, 29 September 2008 and HM Treasury, *Statement by the Chancellor on financial markets*, 13 October 2008.

1 year, which they may renew for a total of 3 years, and the risk of losses on their loans remains with the banks.[52]

3.106 The ASF was supportive of establishing a similar Special Liquidity Scheme in Australia stating that it would be more effective than repos and that 'the advantages of such a scheme would be the certainty of availability of funding and the duration of the funding, being one to three years at the option of the borrower or the issuer.'[53]

3.107 Genworth Financial also endorsed an Australian Special Liquidity Scheme but believed that it would only provide a short term solution noting, as indicated earlier, the need for a long term framework for fundamental lending through all cycles in the housing sector.[54]

3.108 The Rock Building Society was of a similar view noting that ideally there needed to be both a long and short term solution to adding liquidity to the market. They stated:

> I would like to think that Treasury in Australia would be looking at what is happening there [the UK] as well as a very important short-term solution to the liquidity crisis…But I think it is important that we do both, that we look at what can be done in the short term…and then what is good for the long-term health of our financial system.[55]

Conclusions

3.109 The UK's financial sector is vastly different from our own. Our banking sector is considered quite robust in comparison and the Australian Government has not taken the drastic steps of putting our banks under public ownership.

3.110 The UK's Special Liquidity Scheme provided some benefit by adding liquidity to the UK market. The UK Government also appears to have mitigated the risk of taking on mortgage-backed securities to some extent by having any losses on loans remain with the banks.

3.111 As noted above, the UK Government has taken temporary public ownership of Northern Rock and Bradford & Bingley and acquired significant shareholdings in HBOS, Lloyds TSB and the RBS. It is

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52 Bank of England, *News Release*, *Special Liquidity Scheme*, 21 April 2008.

53 Mr G Medcraft, Australian Securitisation Forum, *Transcript*, 15 August 2008, p. 37.

54 Mr P Hall, Genworth Financial, *Transcript*, 15 August 2008, p. 50.

55 Mr D Lightfoot, The Rock Building Society Pty Ltd, *Transcript*, 8 August 2008, p. 6.

therefore hard to ascertain at this stage whether the scheme will add any substantial liquidity to the UK market and bolster competition.

3.112 Also, as noted previously, this type of short term solution will not provide funding for longer term mortgage lending.

The government's support package

3.113 The issue of adding liquidity to the mortgage market for the banking and non banking sectors to access funding for its operations is impacted by the government's financial support package.

3.114 On 26 September 2008, the Treasurer announced that he had directed the AOFM to purchase $4 billion in RMBS. In his media release of 26 September, the Treasurer stated:

> …due to recent extraordinary developments in international capital markets, liquidity in the primary Australian RMBS market has been reduced…This has weakened the capacity of mortgage lenders reliant on the primary RMBS market as a source of funding to compete.
>
> To reinvigorate the Australian RMBS market and support competition in mortgage lending, I will direct the AOFM to invest in AAA rated RMBS in two initial tranches of $2 billion each.[56]

3.115 By the start of October 2008, conditions in international financial markets took a significant turn for the worse with liquidity problems in the global money markets. Governments around the world introduced various packages in an attempt to stabilise their financial systems and add liquidity to the market.

3.116 The US Government offered US$250 billion of capital for its banks, and offered to guarantee directly up to US$1,400 billion of bank debt. The UK Government offered £50 billion of capital for its banks, and offered to guarantee directly up to £250 billion of bank debt. The Canadian Government offered to guarantee directly all wholesale bank debt.[57]

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56 Treasurer of the Commonwealth of Australia, *Media Release, Government Initiative to support competition in the mortgage market*, 26 September 2008.

57 Bank of England, *Financial Stability Report, Issue No. 24*, October 2008.

3.117 As a consequence of actions taken around the world, on 12 October 2008, the Prime Minister announced that the Australian Government would:

- guarantee all deposits of Australian banks, building societies and credit unions and Australian subsidiaries of foreign-owned banks;
- guarantee wholesale term funding of Australian incorporated banks and other ADIs; and
- direct the AOFM to purchase an additional $4 billion in Residential Mortgage Backed Securities from non-ADI lenders.[58]

3.118 The free guarantee on deposits up to $1 million was legislated as part of the Financial Claims Scheme (FCS). The intention of the legislation is to allow the government to make timely payments to eligible depositors and policy holders in the event of a financial institution failure.

3.119 APRA would need to declare the institution insolvent (and unlikely to return to solvency in the near future) and apply for the failed institution to be wound up. Then, the Treasurer would be able to activate the scheme and appropriate the required funds.

3.120 The scheme would be administered by APRA who, in the event of a failure of an ADI or insurer, would make payments to affected depositors or policy holders in a timely fashion and then would be substituted for individual depositors as a creditor (APRA would be given first priority as creditor in any such liquidation).

3.121 Following the insolvency process, any shortfall of funds needed to make up the payments incurred by APRA to deposit holders/insurance policyholders will be recovered through levies on either the ADI or general insurance industries (whichever industry is relevant to the insolvent company). The power to impose these levies is contained within the *Financial Claims Scheme (ADIs) Levy Act 2008* and the *Financial Claims Scheme (General Insurers) Levy Act 2008*. For this reason, the FCS is expected to amount to an eventual nil cost to government.

3.122 The financial claims scheme legislation does not contain anything pertaining to the guarantee of wholesale term funding for ADIs or for the guarantee of deposits above the $1 million threshold. To obtain the benefit for these guarantees a relevant fee must be paid to the

58 Prime Minister of Australia, *Media Release*, *Global Financial Crisis*, 12 October 2008.

government. These arrangements will be implemented through contractual arrangements. The government is currently considering whether other legislative changes are required to give effect to that aspect of the scheme.

Investigating and addressing issues of concern

3.123 Keeping the financial market stable, competitive and healthy is an ongoing concern. As has been highlighted during the course of this inquiry, markets can change dramatically within the space of a few days.

3.124 The Consumer Action Law Centre (CALC) noted that the UK has established a specific body, the Competition Commission, that has powers to investigate and address issues on concern within the marketplace. They stated:

> …in the UK the competition regulators have general 'market studies' and 'market investigations' functions and powers that are simply not available in Australia. These powers have given the UK regulators the ability to address problems within various markets, including the UK retail banking and non banking sectors.[59]

3.125 If the UK Competition Commission's investigations determine that competition in a market could be limited or damaged, they have the power to undertake a range of actions including:

- publishing information to help consumers;
- encouraging firms to take voluntary action or adopt a code of practice;
- making recommendations to the government or other regulators;
- taking enforcement action for breaches of consumer or competition law;
- making a market investigation reference to the Competition Commission; or
- deciding that no further action is warranted.[60]

59 Consumer Action Law Centre, *Submission no. 35*, p. 16.

60 Consumer Action Law Centre, *Submission no. 35*, p. 16.

3.126 The CALC was also of the view that neither the Australian Competition and Consumer Commission (ACCC) nor the Australian Securities and Investments Commission (ASIC) had the power to investigate and address issues on concern within the marketplace. CALC stated:

> …the Australian Competition and Consumer Commission and ASIC are unable to undertake these important studies and investigations where market problems and their solutions are not immediately obvious.[61]

3.127 The ACCC is an independent statutory authority that administers the *Trade Practices Act 1974* and other acts. The ACCC's primary responsibility is to ensure that individuals and businesses comply with the Commonwealth's competition, fair trading and consumer protection laws.[62]

3.128 The ACCC noted that that they were somewhat limited in making comments on competition as they do not undertake extensive market reports which could be undertaken in the UK by the Office of Fair Trading (OFT), stating:

> With mergers and most of our work internally, we look at that transaction and compare it with what exists now as opposed to what we think the overall state of a market is relative to a model of perfect competition, or whatever. It just makes it a little difficult sometimes to make bold statements such as, 'This is extremely competitive,' or, 'This is very competitive,' or whatever, unless you do a full-blown market report. As some of you would know, the OFT in the United Kingdom does a lot of those. They are probably the world's leader in terms of market reports, and they are a different beast, if you like, than a lot of what we do.[63]

3.129 The ACCC also noted that they are interested in competition 'but it is only of interest if it comes across our desk in terms of a merger, an acquisition, an enforcement issue or a compliance issue.'[64]

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61 Consumer Action Law Centre, *Submission no. 35*, p. 18.

62 Australian Competition and Consumer Commission, 'What we do', viewed on 30 October 2008, <http://www.accc.gov.au/content/index.phtml/itemId/54137>

63 Mr M Pearson, Australian Competition and Consumer Commission, *Transcript*, 19 September 2008, p. 24.

64 Mr M Pearson, Australian Competition and Consumer Commission, *Transcript*, 19 September 2008, p. 28.

3.130 ASIC is Australia's corporate, markets and financial services regulator and administers the *Australian Securities and Investments Commission Act 2001*. ASIC's role is to monitor the marketplace for breaches of the ASIC Act and taking enforcement action where appropriate; contributing to policy debates and the development of self-regulatory initiatives; and contributing to consumer education efforts.[65]

3.131 ASIC acknowledged that they did not have a role in assessing competition stating:

> …the ACCC has a role in competition. Obviously mergers or anticompetitive practices of one sort or another in that sector, just like any other sector, would be within their purview, but the consumer protection aspect of financial services is with us.[66]

Conclusions

3.132 Both the ACCC and ASIC are constrained by their respective Acts which do not provide them with the power to independently investigate and report on issues of concern that relate to competition within the marketplace.

3.133 The *Trade Practices Act 1974* already contains a broad range of investigation and enforcement powers in relation to suspected breaches of the Act including, mechanisms to monitor competition in particular industries, and substantial penalties for breaches of the competition provisions. There are also a range of general consumer protection powers.

3.134 Some concerns were raised with the committee regarding whether the current mechanisms were adequate to monitor the state of competition within the banking and non-banking sectors.

Recommendation 4

3.135 **The committee recommends that the government review the current adequacy of the *Trade Practices Act 1974* to provide the Australian Competition and Consumer Commission the powers to investigate and**

65 Australian Securities and Investments Commission, 'Our role', viewed on 30 October 2008, < http://www.asic.gov.au/asic/asic.nsf/byheadline/Our+role?openDocument>

66 Mr J Cooper, Australian Securities and Investments Commission, *Transcript*, 19 September 2008, p. 76.

address issues of concern in markets and regulated sectors.

Positive credit reporting

3.136 Some groups have indicated that there is not a level playing field as Australia's four largest banks hold a distinct competitive advantage in being able to assess the potential risk of a customer and that 'their large existing customer base gives them broad insight into a consumer's ability to make repayments.'[67]

3.137 Currently financial institutions assess a customer's capacity to pay by looking at their credit report. Credit reports contain information on credit applications, credit defaults (overdue payments of 60 days or more), serious credit infringements and whether the individual has filed for bankruptcy. This is called a 'negative credit reporting model'.

3.138 The Treasury noted that the current negative reporting model may 'represent a barrier to competition as they prevent new entrants and smaller existing lenders from obtaining comprehensive information on a prospective customer's ability to service a loan' and that only a 'customer's existing lender…has access to the borrower's repayment history'.[68]

3.139 GE Money noted the difficulties associated with assessing a customer's credit worthiness stating 'GE and many other non-bank lenders are currently at a competitive disadvantage vis a vis the banks with respect to our ability to assess an applicant's capacity and willingness to service debt.'[69]

3.140 Banks in particular, who have more comprehensive client databases, can theoretically make a better judgement about a customer's capacity to pay.

3.141 Some groups believe that all financial institutions should be able to access a borrower's repayment history and are proposing that Australia adopt a 'positive credit reporting model'.

67 VEDA Advantage, *Submission no. 11*, p. 7.

68 Treasury, *Submission no. 32*, p. 16.

69 GE Money Australia and New Zealand, *Submission no. 13*, p. 4.

3.142 VEDA Advantage, the main proponents of a positive credit reporting model, argued that 'a [negative] credit report really does not tell you about your capacity to repay or in fact whether you are financially stressed.'[70]

3.143 VEDA Advantage also pointed out that 'Australia, New Zealand and France are now the only three OECD nations limiting credit reports to just negative information.'[71]

3.144 The Australian Finance Conference also supported the positive credit reporting model indicating that 'it would enable our members to better manage risk and consequently make better informed lending decisions.' They also noted that 'its inclusion should see a boost in competition among financiers and lead to lower interest rate credit products for low-risk consumers.' [72]

3.145 Additionally, there is a perception that people on low incomes pose a greater credit risk. Based on a the current risk assessment process, people on low incomes are generally given a much smaller choice in credit products at a much higher interest rate.

3.146 The Brotherhood of St Laurence noted that 'Banks have developed risk assessment policies and conditions which make them inappropriate for people on low incomes.'[73]

3.147 Being on a low income does not necessarily equate to being a credit risk. The Brotherhood of St Laurence also noted that 'low-income people hold a significantly lower amount of debt than higher income people' and 'the default rate for loans to people on low incomes is actually lower than the industry average for people on higher incomes.'[74]

3.148 A positive credit reporting model may assist people who are on low incomes to obtain lower interest rate credit products.

3.149 As noted by the Treasury, the Australian Law Reform Commission (ALRC) has also examined the credit reporting system. On 30 May 2008, the ALRC delivered their final report, *For Your Information: Australian Privacy Law and Practice*, which recommended that 'there should be some expansion of the categories of personal information

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70 Mr M Strassberg, VEDA Advantage, *Transcript*, 15 August 2008, p. 4.

71 VEDA Advantage, *Submission no. 11*, p. 11.

72 Australian Finance Conference, *Submission no. 18*, p. 5.

73 Ms G Sheehan, Brotherhood of St Laurence, *Transcript*, 8 August 2008, p. 61.

74 Ms G Sheehan, Brotherhood of St Laurence, *Transcript*, 8 August 2008, p. 61.

that can be included in credit reporting information held by credit reporting agencies' including:

- the type of each current credit account opened (eg, mortgage, credit card, personal loan);
- the date on which each current credit account was opened;
- the credit limit of each current account; and
- the date on which each credit account was closed.[75]

3.150 The ALRC President, Professor David Weisbrot, recognised that the current credit reporting model had limitations stating:

> It is hard to justify the present, artificial limitations, which do not accord with standard practice in the rest of the industrial world. The recommended moderate expansion in the types of information that may be recorded on a credit file falls short of the more open US or UK regimes advocated by some credit providers, but that is because the ALRC recognises that there are competing interests at play, and we have sought to place an appropriately high premium on the privacy and security of sensitive personal information.[76]

3.151 As alluded to by the ALRC President above, adopting a positive credit reporting model has privacy implications. Veda Advantage noted the current concerns of privacy advocates stating:

> There are some privacy advocates who believe that any database of information is dangerous and a human rights breach. I think we will never satisfy those, but most consumer advocates now accept that we have got good data governance and good ways of regulating it.[77]

3.152 While undertaking an examination of the credit reporting system, the ALRC also recognised the concerns of privacy and consumer advocates noting that 'privacy and consumer advocates also argued strongly that allowing more personal information on the financial position and credit behaviour of individuals to be collected in private sector databases would pose greater risks to security and privacy.'[78]

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75 Australian Law Reform Commission, *Media Briefing Note 7, ALRC Privacy Inquiry, Reform of the credit reporting system*, 11 August 2008.

76 Australian Law Reform Commission, *Media Briefing Note 7, ALRC Privacy Inquiry, Reform of the credit reporting system*, 11 August 2008.

77 Mr C Gration, Veda Advantage, *Transcript*, 15 August 2008, p. 6.

78 Australian Law Reform Commission, *Media Briefing Note 7, ALRC Privacy Inquiry, Reform of the credit reporting system*, 11 August 2008.

Conclusions

3.153 The proposal for Australia to adopt a positive credit reporting model has advantages for both the business and the consumer.

3.154 However, there will always be some extenuating circumstances that cannot be predicted by either a negative or positive credit reporting model. This includes a significant change in an individual's life, such as illness, divorce or the loss of a job, can inhibit the individual's capacity to pay.

3.155 The committee believes that the benefits that such a model would provide to enable businesses to better assess risk outweigh any limitations. The fact is that there will always be some extenuating circumstances that any model will be unable to predict.

3.156 The committee believes that there are some privacy concerns about expanding the categories of personal information held by credit reporting agencies but notes that the ALRC has undertaken an examination of the impact on privacy and security of personal data before it made its recommendation to government.

3.157 The committee concurs with the ALRC's recommendation that there should be some expansion of the categories of personal information that can be included in credit reporting information held by credit reporting agencies.

Recommendation 5

3.158 **The committee supports the findings of the Australian Law Reform Commission's report and urges the government to implement the report's recommendations on reforming Australia's credit reporting system.**

4

The account switching facilitation package

Introduction

4.1 The Australian Government advocates that while competition in the banking sector has improved over the last decade or so, more could be done to encourage and improve competition in this sector, in particular, removing impediments to competition from new and existing providers. Any improvements to competition in the banking sector would lead to improvements to the financial products on offer and ultimately provide better value for consumers.[1]

4.2 Improving the ability of personal banking customers to switch accounts is an obvious way to improve the competition between suppliers of financial products.

4.3 Internationally, assisting consumers to switch accounts between financial institutions has gained attention and support from the Organisation for Economic Cooperation and Development (OECD)[2] and the European Commission[3] (EC).[4] Both organisations have found

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1 Treasury, *Submission no. 32*, pp. 10-11.

2 The OECD was established by treaty in 1961 and currently has 30 member countries. The OECD collects country economic and social information including monitoring trends, conducting research and examining patterns in areas such as trade, the environment, agriculture, technology and taxation. OECD, viewed 22 October 2008, <www.oecd.org>.

3 The EC was established by treaty in the 1950s and is the executive arm of the European Union, responsible for implementing the decisions of the European Parliament and the Council which includes managing the routine of business of the European Union,

that there is 'scope to enhance competition by helping customers to more easily move between providers.'[5]

4.4 The switching rate in Australia's transaction account market is approximately three percent. This represents about half that of the United Kingdom of Great Britain (UK) and is below the European Union[6] average.[7]

4.5 Members Equity Bank (ME Bank) stated that most bank customers are unhappy with their bank, but find it difficult to exercise personal choice and switch banks. ME Bank stated:

> The average consumer in the Australian banking system is unhappy as publicly available data shows, but they are not switching, it must be too hard. If people are unhappy with their carrier in their mobile phone service they switch. Almost every other industry has higher satisfaction ratings and that is why we get this phenomenon called bank bashing. What I really support is policy intervention to make sure that it is easy for people to switch so that they can exercise the choice when they are dissatisfied.[8]

4.6 Professor Joshua Gans summed up the crux of the argument for facilitating switching and the cascading benefit of greater consumer choice creating greater competition in the personal banking sector, stating:

> It is not a matter of rocking in to a new bank and taking advantage of a deal, let alone trying to investigate and work out what is best for you. It would be a lot of work. Moreover, for what return? When it comes down to it—especially now—we do not have too many options regarding different pricing models and different things from the major banks. Would

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implementing its policies, running its programs and spending its funds. EC, viewed 22 October 2008, <http://europa.eu/institutions/inst/comm/index/_en.htm>.

4 Treasury, *Submission no. 32*, p. 11.

5 Treasury, *Submission no. 32*, p. 11.

6 The European Union (EU) was established in 1992 by the Maastricht Treaty and is the economic and political partnership of 27 democratic signatory European countries operating under the Euro currency. Governance of the EU includes the European Commission, the Council of the European Union, the European Parliament, the European Court of Justice, the Court of Auditors, the European Economic and Social Committee, the Committee of the Regions, The European Central Bank and the European Central Bank. EC, viewed 22 October 2008, <http://Europa.eu>.

7 Ms E Freeman, CHOICE, *Transcript*, 21 August 2008, p. 75.

8 Mr A Wamsteker, Members Equity Bank, *Transcript*, 19 September 2008, p. 66.

> you get a sufficient amount of return to make that switch? It is unclear. That is part of the problem as well. But without the potential for it, the market cannot do its job. So really there is a value to spur of the moment ability to switch between providers that can keep people disciplined. We have it more or less now in telecommunications; we have had it for years in your corner store, your petrol station or anything like that. As we get more and more stuff being relied upon—and it is an increasing problem with the banks—I think we need to look at it now, because basically there is a web of interlocking transactions that you need to move now in order to switch banks, and that is difficult, not to mention the spectre of things like exit fees on mortgages and so on.[9]

Account switching

Background

4.7 In late 2006 on the request of the then Treasurer,[10] the Australian Payments Clearing Association (APCA)[11] set about devising and coordinating the implementation of an 'Account Switching Facilitation Package' (the Switching Package).

4.8 The need for a switching package evolved from an initial investigation conducted by the Australian Bankers' Association (ABA) into the barriers encountered by consumers wanting to change their financial institution. ABA's report found that there were no structural or financial barriers to switching. Rather, barriers to switching were created by the 'perceived hassle of changing accounts due to the large number of steps taken' to switch between financial institutions.[12]

9 Professor J Gans, *Transcript*, 21 August 2008, p. 73.

10 Hon Peter Costello MP.

11 The Australian Payments Clearing Association was established in 1992 and is the Australian payments industry's principal self-regulatory body and the primary vehicle in Australia for collaboration within the payments industry. APCA is tasked with improving 'the safety, reliability, equity, convenience and efficiency of the Australian payments system. APCA achieves this through industry self-regulation and standards; industry change management and industry policy development and advocacy.' APCA, *Submission no. 43*, p. 1.

12 Australian Payments Clearing Association, *Progress Report on Implementation of an Account Switching Facilitation Package*, 2 April 2008, p. 4.

4.9 To resolve the time and effort experienced by potential switchers, the ABA suggested investigating the option of establishing a central account registry as a repository of financial consumers' direct debit and credit arrangements. In addition to this option, the Treasurer asked the ABA to consider alternative options to 'facilitate the portability of direct credit and debit arrangements.' [13]

4.10 In late 2007, APCA issued a discussion paper in response to the then Treasurer's request which explored switching options for Australia.

The account switching reform agenda

4.11 The Switching Package was announced in early 2008, following public consultation undertaken in 2007 and subsequent discussion between the Treasury, ABA, Abacus Australian Mutuals (Abacus) and APCA.[14]

4.12 The aim of the Switching Package is to improve the efficiency and ease of changing or switching transaction accounts for financial consumers and, in the process, encourage competition.[15]

4.13 The Switching Package specifies that:

- 'the old financial institution will provide a list of the customer's direct debit and credit arrangements over the past 13 months to the customer in order to facilitate the establishment of the arrangements for the new account';
- 'the new financial institution will provide the customer with information and support to help the customer make the switch. If requested by the customer, the new financial institution will assist in notifying the billing or crediting organisations of the new direct debit and direct credit arrangements';
- 'the service will be supported by obligations in industry codes of practice. This will include obligations concerning timeliness and to provide information to customers on how to avoid exception fees, and to deal fairly with customers throughout the account switching process;

13 Australian Payments Clearing Association, *Progress Report on Implementation of an Account Switching Facilitation Package*, 2 April 2008, p. 4.

14 Australian Payments Clearing Association, *Progress Report on Implementation of an Account Switching Facilitation Package*, 2 April 2008, p. 2.

15 Australian Payments Clearing Association, *Submission no. 43*, p. 1.

- APCA is also supporting the efforts of financial institutions by:
  - ⇒ developing generic information and support material for customisation by financial institutions in supporting consumer account switching; and
  - ⇒ developing a costed project plan and member proposal for a database to capture and maintain debit user contact details to facilitate account switching, with an obligation on sponsoring financial institutions to provide this information.
- APCA, through its Low Value Payments Industry Direction Project, will ensure that convenience of switching direct debit and credit arrangements is considered in the development of future payment system proposals.'[16]

4.14 Due to its responsibility for the Bulk Electronic Clearing System[17] (BECS) and the benefit of being able to draw on its extensive membership, APCA undertook to coordinate a consultation process and devised the subsequent Switching Package. The exercise was conducted over four phases: scoping, planning, development and implementation.[18] The scope of the account switching package would be limited to personal transaction accounts and does not include:

- transaction accounts not owned by a personal customer eg. business accounts;
- direct debit and credit arrangements not processed through BECS;
- direct debit and credit arrangements on credit card accounts;
- transactions conducted using the 16 digit scheme debit card number; and
- closing of the customer's current transaction account.[19]

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16 Australian Payments Clearing Association, *Submission no. 43*, pp. 1-2; Australian Payments Clearing Association, *Progress Report on Implementation of an Account Switching Facilitation Package*, 2 April 2008, pp. 2-3.

17 The Bulk Electronic Clearing System is the main method used for the processing of direct credit and debit transactions within Australia. APCA, *Progress Report on Implementation of an Account Switching Facilitation Package*, 2 April 2008, p. 2.

18 Australian Payments Clearing Association, *Progress Report on Implementation of an Account Switching Facilitation Package*, 2 April 2008, p. 5.

19 Australian Payments Clearing Association, *Progress Report on Implementation of an Account Switching Facilitation Package*, 2 April 2008, p. 6.

4.15 Since late 2007, APCA has produced four interim reports on the status of the implementation process. The Switching Package was implemented on 1 November 2008.

4.16 Until the Switching Package was implemented, interim arrangements had been left up to individual financial institutions to manage and were not reported on.[20]

4.17 The Treasury commented that the current Switching Package is a significant step forward, will empower consumers and is tailored to Australia's payment system.

> The current switching arrangements have been very much designed to fit within Australia's current payment system architecture. That is important. They are a significant advance on the current arrangements. Some of the banks have had arrangements in place, but the winning bank,—I guess you would call it—has maybe had a switching pack in place that assists a customer who has come into them to switch. However, this will impose obligations on the losing bank to get all the direct debit and credit arrangements for the customer. The customer then goes to the new bank, and they are under an obligation if the customer requests to re-establish all those direct entry arrangements. That is a significant step. Once it is in place from 1 November, the obligations will be contained in what is called the bulk electronic clearing system regulations of the Australian Payments Clearing Association. Consumer complaints can be actioned through what is now the financial ombudsman service. There will be some bite to them. It is a significant advance. It is really looking to address that consumer inertia problem or the hassle that has been identified not only in Australia but also internationally.[21]

4.18 In addition to the Switching Package, the government is advocating changes to other elements related to competition in the personal banking sector. This includes simplifying the products available, improving product disclosure requirements[22] and, through the Australian Securities and Investments Commission (ASIC), investigating mortgage entry and exit fees.

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20 Australian Payments Clearing Association, *Progress Report on Implementation of an Account Switching Facilitation Package*, 2 April 2008, p. 4.

21 Ms K Wijeyewardene, Treasury, *Transcript*, 14 August 2008, p. 34.

22 Treasury, *Submission no. 32*, p. 11.

Card scheme inclusion

4.19 Including card schemes in the switching process would have the benefit of creating greater flexibility for consumers and promote competition. In many cases, mortgage holders also have credit cards with their mortgage provider and so may believe they are locked into a particular card scheme as a result.

4.20 In March 2008, APCA invited card schemes to identify ways to facilitate easy switching of 'direct debit and credit arrangements made through credit and debit cards'. The Treasurer also urged card schemes to participate in the 'switching' process. APCA has since held discussions with Visa International and Mastercard to facilitate the process. [23] Diners Club and Amex have also indicated their interest in participating.[24]

4.21 Abacus commented that there is already significant switching between card schemes with 35 percent of credit cards switched within three years. Abacus commented:

> In terms of the credit card question, I think one of the key issues to remember is that in fact there is already quite a degree of switching within the credit card market. Datamonitor put out a report quite recently that suggested about 35 per cent of credit cards are switched within three years, so that is a fair degree or proportion of credit cards. It is also important to remember too that in the credit card space there are some issues around the card schemes, and their ability to get the card schemes to come on board with account switching proposals. I guess the point there is that the implementation issues do not all sit with financial institutions. There are some card scheme issuers there as well. And the APCA working group that has been working on account switching has been engaged with the card schemes to see what is possible in that space.[25]

23 Australian Payments Clearing Association, *Second Progress Report on Implementation of an Account Switching Facilitation Package*, 30 April 2008, p. 3.

24 Mr C Hamilton, Australian Payments Clearing Association, *Transcript*, 21 August 2008, p. 30.

25 Mr M Degotardi, Abacus Australian Mutuals, *Transcript*, 21 August 2008, p. 8.

Progress on the switching package

4.22 The Switching Package was implemented on 1 November 2008.[26]

4.23 In addition to arriving at a Switching Package, APCA monitored the switching progress of participating members through member's regular reporting.[27]

4.24 APCA stated that during the consultation process that it addressed new issues that arose resulting in continuous improvement.[28]

4.25 APCA has indicated that the success of the Switching Package will depend on the third parties that 'generate regular payments to and from consumer accounts through their own financial institution.'

Conclusions

Card scheme inclusion in the switching regime

4.26 The committee supports the combined effort of the government and APCA to encourage card schemes to participate in the new switching regime.

4.27 The committee accepts that it is relatively easy for consumers to switch between card schemes. However, the committee notes that a consumer that holds a mortgage may also hold a credit card with the same mortgage provider and so may feel inhibited from switching between card schemes.

Recommendation 6

4.28 **The committee recommends that consideration be given to including card schemes in the Account Switching Package.**

26 Australian Payments Clearing Association, *Fourth Progress Report on Implementation of an Account Switching Facilitation Package*, 31 August 2008, p. 5.

27 Australian Payments Clearing Association, *Fourth Progress Report on Implementation of an Account Switching Facilitation Package*, 31 August 2008, p. 5.

28 Mr C Hamilton, Australian Payments Clearing Association, *Transcript*, 21 August 2008, p. 25.

Account number portability

4.29 The idea of account switching is gaining momentum in Australia with double-digit growth annually of electronic direct debit and credit transfers. This is because the use of electronic payments is relatively easy to establish and use and available through any financial institution.[29] It is in this environment that the prospect of gaining greater efficiency through the portability of account numbers is being considered.

4.30 Portability of an account number relates to a customer's ability to retain a particular number which identifies a particular account (or their account number) when moving from one financial institution to another.

4.31 Proponents of account number portability argue that the added benefit of moving towards account number portability will provide flexibility for consumers and improve competition across the personal banking sector.

4.32 The Switching Package has been engineered around BECS and any measures to introduce account number portability would mean making changes to the present payment system.

Australia's Bulk Electronic Clearing System

4.33 Australia's BECS was established in 1994 and is the 'unified self-regulatory framework for the exchange and settlement of direct credit and debit transactions amongst banks, building societies and credit unions.'[30]

4.34 BECS allows Direct Entry Users (DE Users) to electronically credit and debit large numbers of accounts regularly. DE Users are those business or personal entities given permission to credit or debit a person's account through their financial institution. DE Users include 'businesses offering repayment facilities, bodies such as health insurance companies offering monthly repayments of premiums or employers paying salaries to employees.' [31] As at June 1997, more than

29 Mr C Hamilton, Australian Payments Clearing Association, *Transcript*, 21 August 2008, p. 26.

30 Australian Payments Clearing Association, *Payments Industry Consultation Paper: Aspects of Account Switching*, September 2007, p. 6.

31 Australian Payments Clearing Association, *Payments Industry Consultation Paper: Aspects of Account Switching*, September 2007, pp. 6-8.

219 000 organisations were registered as DE Users. Currently, direct credit and debit transactions account for 32.1 percent of total non-cash retail transactions and 81.5 percent in value.[32]

4.35 BECS has evolved to be used for internet and telephone banking transactions and is 'considered to be highly cost-effective and an efficient mechanism for handling high volumes of mostly low value electronic payments.'[33]

4.36 BECS operates through 'a decentralised infrastructure with payments bilaterally exchanged through computer links between financial institutions.' This is different to countries such as the UK, the Netherlands and New Zealand where credit and debit transactions are processed through a 'central processing switch'.[34]

4.37 The differences between a decentralised and a centralised payments structure and the resulting impact on enabling switching is further discussed in relation to account number portability and the proposal for the establishment of a central account registry.

Account number ownership

4.38 The process of taking your account number with you when changing financial institutions has been compared to the process that exists when a mobile telephone customer changes telecommunication providers and opts to keep their telephone number.[35]

4.39 APCA was of the view that it is not appropriate to compare the process that introduced mobile telephone number portability to that of account number portability as the telecommunications industry is very different to that of the retail-banking sector.

4.40 APCA stated that creating account number portability is complicated and costly and as stated by Abacus would involve changes to the current Bank State Branch (BSB) number system, which is used to identify various parts of an institution. Further, APCA stated that there would have to be changes to an individual institution's software

32 Australian Payments Clearing Association, *Payments Industry Consultation Paper: Aspects of Account Switching*, September 2007, pp. 6-8.

33 Australian Payments Clearing Association, *Payments Industry Consultation Paper: Aspects of Account Switching*, September 2007, p. 8.

34 Australian Payments Clearing Association, *Payments Industry Consultation Paper: Aspects of Account Switching*, September 2007, p. 9.

35 *Transcript*, 21 August 2008, pp. 30 and 64; Members Equity Bank, *Transcript*, 19 September 2008, p. 57.

systems creating an initial cost for a large number of private and public entities. APCA stated:

> In Australia the BSB number is part of the identity of the relevant part of the institution. It is used for cheque clearing; it is used for a great many internal processes. The entire financial systems of the institution—it varies from institution to institution—are quite often built around the fact that their business is organised into BSBs as it were, so it is much more fundamental than routing payments. [It is] … like a post code. It is more like saying that that is where to send this particular payment and it is used for a whole bunch of other purposes. If you want to move houses, asking to take your post code is challenging and does not make a huge amount of sense. … the reality is that one has to look at the underlying structure rather than look at the amount.
>
> In terms of the number of digits mobile phone numbers basically all had the four-digit prefix and then the six digits following that. Account numbers actually had different lengths with different financial institutions. Immediately there you start to create problems in terms of the numbers of individual characters. Quite often financial institution software is built around those specific protocols. If an institution says that a certain type of account number is a certain length, then the systems will only be able to deal with that certain length of an account number too. Again, that is quite often built into the software of people who may pay into that bank as direct credit users.
>
> For instance, government agencies that pay into accounts in those organisations or businesses or employers who pay into those accounts are likely to have software that is set up to say that if the BSB identifies a certain financial institution then the length of the account number will be eight numbers, nine numbers or 10 numbers. So right there you have to start thinking about rewriting all of that software and making those changes, which again—and I think this is the important point that we need to realise—is not just about banks flicking a switch. It is also about getting government agencies and employers to spend a lot of money on their own systems to make sure that they can pay into bank accounts for

> individuals, whether it is government benefits, wages, salaries et cetera.[36]

4.41 In contrast to the previous views about potential problems with account number portability, Professor Gans is a proponent of account number portability and found that portability would enable efficient switching and promote greater competition between financial institutions. Account number portability would mean giving consumers 'ownership' of their account number.[37]

4.42 Professor Gans advocated that the cost of setting up a system to support account number portability should not be an impediment to the process and cites the example of the costs encountered when mobile telephone number portability was implemented. Professor Gans stated:

> The chief objection that comes up is: it is going to cost a fortune; think of what it will do to us. Let me react to that in two dimensions. First of all, that is exactly what the telecommunications companies told us. They told us it was going to cost billions of dollars and would pretty much make Telstra, for instance, bankrupt if it were imposed without subsidisation costs, people being charged for the move and so on. Government said, 'Forget it. You'll do it anyway.' It did not even show up on their balance sheets; it was literally another line in the database, as it turns out. At the moment we have ACCC sanctioned and authorised standard-setting bodies for working out cooperative deals on payment systems and electronic transfer and all those things. These cooperative arrangements have been a hallmark of the banking system forever. The banks can do it in much the same way. I would be willing to take the punt that it is not going to cost them very much at all if they are forced to do it.[38]

4.43 ING Direct also favoured account portability as a means to allow for easy switching and highlighted the ease of switching between superannuation funds as an example.

> I always refer to a far more significant one in superannuation. I could—I wish!—potentially transfer hundreds of thousands

36 Mr C Hamilton and Dr B Pragnell, Australian Payments Clearing Association, *Transcript*, 21 August 2008, pp. 29-30.

37 Professor J Gans, *Transcript*, 21 August 2008, p. 64.

38 Professor J Gans, *Transcript*, 21 August 2008, p. 65.

> of dollars by giving an authorisation to one of the funds managers to transfer to the other, as easily as snapping my fingers. Yet switching my gym membership is far more difficult. I think there is an irony there.[39]

4.44 One option put forward to simplify 'switching' was to create a central account registry independent of any financial institution.

Portability of account numbers in the UK

4.45 Within Australia, there is support for the UK model that provides for portability of account numbers.[40]

4.46 In Australia, a customer that changes financial institutions is responsible for notifying the DE User of the change as the DE User holds the customers authority for crediting or debiting their account.

4.47 Compared to Australia the UK has an inverse relationship between the DE User and the customer's financial institution. The UK system provides that the customer's financial institution holds the customer's authority.

4.48 BankWest advocates that adoption of the UK system would allow for greater efficiency in notifying DE debit users of any changes in account details.[41]

4.49 Abacus counters this view by stating that the UK system creates inconvenience for customers at the front end of the process instead of at the back end of the process. Further, Abacus was of the view that adopting the UK system may make it more difficult to establish financial transactions as the current Australian system for account identifiers would have to be changed. Abacus stated:

> …there are more things to be considered, I guess, than just the difficulty of changing direct debits at the end of the day. In the UK example, for instance, to set up a direct debit you have to go to the bank and the merchant, and that is a bit of a pain for consumers at the front end. What we would hate to see is that proposals to make it easier to switch accounts in

39 Mrs L Claes, ING Direct, *Transcript*, 16 October 2008, p. 6.

40 Bank of Western Australia Ltd, *Submission no. 29*, p. 9; Professor J Gans, *Submission no. 2*, p. 2.

41 Bank of Western Australia Ltd, *Submission no. 29*, p. 9.

> fact make it hard to set up financial transactions generally in the first place.[42]

A central account registry

4.50 During the course of its investigation into switching, APCA reviewed switching arrangements in place in countries where clearing and settlement of direct credit and direct debit occur via a central processing switch such as in New Zealand, the Netherlands and the UK (unlike Australia which has a bilateral arrangement).[43]

4.51 An extension of Australia's Switching Package has been suggested through investigation into the establishment of a central account registry similar to the Dutch *Interbank Switch Support Service*. [44]

4.52 BankWest justified establishing a central account registry, as 'in turn this would facilitate the portability of' account switching and promote competition.[45]

4.53 Professor Gans cited the telecommunications industry as the forerunner for implementing number portability and efficient switching between providers, thereby improving competition through a central registry type arrangement.[46]

4.54 In response to the proposition of establishing a central registry, APCA stated that it would be very costly because of the difficulty in transmuting Australia's BECS. APCA argued that BECS operates in a different way to that of the European payment system and cannot be compared. APCA stated:

> The other observation to make—and I think this has been made to you several times—is that the structure in most European payment systems is quite different from the structure here. It is neither better nor worse—both have strengths and weaknesses—but the reality is that that makes a central registry framework here harder to implement and

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42 Mr M Degotardi, Abacus, *Transcrip*t, 21 August 2008, pp. 8-9.

43 Australian Payments Clearing Association, *Payments Industry Consultation Paper: Aspects of Account Switching*, September 2007, pp. 12 and 14.

44 Bank of Western Australia Ltd, *Submission no. 29*, p. 10; Professor J Gans, *Transcript*, 21 August 2008, p. 65.

45 Bank of Western Australia Ltd, *Submission no. 29*, p. 9.

46 Professor J Gans, *Transcript*, 21 August 2008, p. 64.

> ratchets up the cost side of the equation a little bit. There is no question that that is a solution which can be looked at, and indeed it was looked at. Our judgement was that a similar level of benefit, if you like, could be obtained from a much more cost-effective implementation—one, importantly, which was cost-effective not only for financial institutions but also for that very large number of business and government users of the payment system.[47]

4.55 APCA noted that the cost of the Dutch switching system cost approximately 10 to 20 million Euros for initial implementation and 2 to 3 million Euros per annum to maintain. Account number portability cost financial institutions in the range of approximately 500 million Euros. APCA made the point that setting up a similar system in Australia would cost far more than the set up costs for the Dutch system.[48]

4.56 APCA stated that the issue of a central registry had been investigated and that the current switching package was the best solution. APCA stated:

> The judgement of the group working on this was that there is a solution which is feasible here, which has a material improvement for consumers, which ameliorates the account-switching stickiness, if you like, and which does not have the same cost and inconvenience for the broad community. I am thinking not just about financial institutions, obviously, but also about that broad community of users of the system.[49]

4.57 The Treasury explained that a central registry option had been explored but was not practical because of the cost involved and the need to have merchant participation.

> The reason we did not go down that path was because of the way that direct entry arrangements are held in Australia. Direct debit and credit authorities are actually held by the merchants, whether it is your gym membership or whatever. They hold those arrangements. To establish a central registry would require not just the banks to be involved, but also

47 Mr C Hamilton, Australian Payments Clearing Association, *Transcript*, 21 August 2008, pp. 27-28.

48 Dr B Pragnell, Australian Payments Clearing Association, *Transcript*, 21 August 2008, p. 28.

49 Mr C Hamilton, Australian Payments Clearing Association, *Transcript*, 21 August 2008, p. 28.

> every merchant in Australia that holds direct credit and debit arrangements. That would be quite costly. They would have to voluntarily or compulsorily participate in this system. Potentially to do so would increase the cost of their services and increase the cost to consumers.[50]

4.58 Abacus[51] and National Australia Bank (NAB) were of a similar view to ME Bank in relation to the proposal for a central registry and recommended waiting to see the results of the Switching Package before proposing the establishment of a central registry. NAB stated:

> Our view would be that it is a little premature to be talking about what needs to be done beyond the current system because we are still going through the process of implementing the current changes. The formal process, of course, is not taking effect until 1 November. We have put in places, as other banks have, interim measures to make it easier for people to move their accounts between banks. The short answer would be, let us allow the system to get in place before we talk about what else needs to be done. There is no doubt that it is a complicated thing to do because of our structures, particularly with direct debits and the arrangements that are made with merchants, rather than directly with banks, but to change that is also a major re-engineering exercise involving a lot of banks and a lot of merchants who provide the direct debit services. We would hesitate before rushing into making those very fundamental changes. Our view would be to wait and see how the current system works before we embark on something a bit more ambitious.[52]

Electronic facilitation of switching

4.59 There were a number of proponents advocating moving to an electronic system of account information exchange. This would save time and effort and improve competition through efficiency of delivery of information.

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50 Ms K Wijeyewardene, Treasury, *Transcript*, 14 August 2008, p. 34.

51 Ms L Petschler, Abacus Australian Mutuals, *Transcript*, 21 August 2008, pp. 9-10.

52 Mr S Munchenberg, National Australia Bank, *Transcript*, 19 September 2008, p. 7.

4.60 CHOICE was in favour of switching, wanted to see an automated or electronic system to facilitate the process, and advocated this as a role for the government.

> More broadly, we would like to see the banking industry commit to developing an automated system, one that means a consumer can make a single request to their new financial institution to change their payment details. The system should be free to customers and remove the risk of penalty fees applying as a result of problems with timing. A simple, consumer friendly, account switching system is essential for competition in the transaction account market. But, ultimately, if the industry cannot deliver simple switching then it is up to the government to step in to achieve that.[53]

4.61 ING Direct was also in favour of an electronic system to facilitate switching and stated:

> Rather than going through the triangle of transfer, the reforms APCA is recommending or that are to be implemented in November force banks to give a list of the debits and credits for the last 13 months. If that could be done electronically, with the customer's consent of course, to the incoming bank that would certainly oil the wheels of switching and open up competition in this very active space.[54]

4.62 ME Bank advocated the simplest approach would be to implement the Switching Package first and then move to a system where information could be exchanged electronically. ME Bank stated:

> I would go for the simplest approach first. To me, that is the simplest and most straightforward to start with. I think that will work in practice. It is very similar to being allowed to take your phone number when you change carriers. The banks have the data. You need to give them a bit of lead time for all of us to get it all together. We will, in the end, find a quick and convenient way to exchange it electronically and off you go.[55]

53 Ms E Freeman, CHOICE, *Transcript*, 21 August 2008, p. 75.

54 Mrs L Claes, ING Direct, *Transcript*, 16 October 2008, p. 3.

55 Mr A Wamsteker, ME Bank, *Transcript*, 19 September 2008, p. 57.

Conclusions

4.63 The committee acknowledges and supports the work undertaken by the government and industry to arrive at a Switching Package.

4.64 The committee accepts and supports that the Switching Package may assist consumers to exercise personal choice, thereby positively affecting competition in the personal banking sector.

4.65 The committee received conflicting evidence about the ease of implementing a system that would allow for account number portability. The committee acknowledges that account number portability would be very convenient for the consumer and would assist consumers to switch easily by cutting down the number of steps taken to execute a switch.

4.66 The committee accepts evidence, which suggests that a central account registry could improve the efficiency of switching between financial institutions, but also understands that there may be significant costs in moving from a bilateral to a more centralised system.

4.67 The committee would like to see an examination of the costs and benefits of implementing a system, which could support a more centralised account switching process which would allow financial institutions to undertake this process on behalf of the consumer. The committee also believes that privacy considerations need to be taken into account under such a model.

4.68 The committee is aware that Australia's payments system operates differently to that of the Netherlands. However, the committee would also welcome a thorough investigation of the costs and benefits of implementing a switching system similar to that of the Netherlands.

Recommendation 7

4.69 **The committee recommends that after 12 months in operation, the Treasury review the Account Switching Package with consideration being given to any areas in which it may be enhanced, including consideration of the costs and benefits of a more centralised account switching system, such as those in operation in the UK and the Netherlands.**

Other issues

ASICs review of mortgage entry and exit fees

4.70 In addition to examining switching, the Australian Government requested ASIC to review mortgage entry and exit fees and the information provided to customers about such costs.[56]

4.71 While not part of the Switching Package, entry and exit fees can create barriers to competition acting as a disincentive for consumers wanting to change from the financial institution providing their mortgage product to another with a better interest rate.

4.72 As part of its review, ASIC examined all fees applicable, for the first three years to an average home loan borrowed with a repayment life of 25 years. These fees included entry fees, ongoing monthly or annual fees, discharge fees and any early termination fees that may apply if the loan 'were terminated or refinanced just short of three years.'[57]

4.73 ASIC identified four types of mortgage fees that are charged: entry fees, ongoing fees, service fees and exit fees.[58]

Entry fees

4.74 Entry fees, which are loan set up charges imposed by the lender or broker, range from $0 to $1,760 and include:

- application fees – charged to consumers when they make a loan application;
- establishment fees – charged to consumers when the mortgage facility is created;
- valuation fees – charged to consumers for the valuation of their property;
- legal fees – charged to consumers for the preparation of necessary paperwork; and

56 Treasury, *Submission no. 32*, p. 13.

57 Australian Securities and Investments Commission, Report 125: *Review of mortgage entry and exit fees*, April 2008, p. 2.

58 Australian Securities and Investments Commission, Report 125: *Review of mortgage entry and exit fees*, April 2008, p. 3.

- settlement fees – charged to consumers for the lender's attendance at the property settlement transaction.[59]

Exit fees

4.75 The lender charges exit fees if a mortgage is terminated or refinanced. There are three main types of exit fees:

1. **Early termination fees** (also known as deferred establishment fees or early repayment fees) are charged for variable rate loans terminated in the first five years and in some cases beyond this timeframe. Termination of the loan may be either through early repayment of the full loan or through refinancing with another lender. These fees can be a fixed dollar amount, a percentage of the original loan amount or a multiple of the standard monthly repayment. In addition, 'some lenders apply a sliding scale for early termination fees' or the earlier the termination during the life of the loan, the higher the fee.[60]

2. **Early termination fees** (also known as break costs) apply to fixed rate mortgages terminated before maturity. These fees are 'calculated by reference to the gap between the fixed interest rate and the prevailing market interest rate at the date of early termination over the remaining term of the loan.' Where a consumer terminating such an arrangement has a lower rate than the market rate, the break fee will be lower than a consumer who does the same, but where the fixed rate loan has a higher interest rate than the market interest rate.[61]

3. **Termination fees** (also known as discharge fees) apply for the discharge of a mortgage and include the 'release and update of the property owner's certificate of title.'[62]

59 Australian Securities and Investments Commission, Report 125: *Review of mortgage entry and exit fees*, April 2008, p. 3.

60 Australian Securities and Investments Commission, Report 125: *Review of mortgage entry and exit fees*, April 2008, p. 4.

61 Australian Securities and Investments Commission, Report 125: *Review of mortgage entry and exit fees*, April 2008, p. 4.

62 Australian Securities and Investments Commission, Report 125: *Review of mortgage entry and exit fees*, April 2008, p. 4.

The Australian experience

4.76 In Australia, mortgage fees are higher than those charged in the UK and the United States of America (US). Recent turmoil in international credit markets has contributed to an upward trend in such fees. [63]

4.77 In its review, ASIC found from a report produced by Fujitsu Consulting and JP Morgan that 'Australian consumers are not always presented a clear picture when assessing mortgage products. There are a wide range of fee variations in the Australian market and consumers need to make a trade-off between interest rates and fees, with a lower headline rate having the potential to attract higher fees for application, valuation, legals and settlement.'[64]

4.78 In comparison to the UK and US, Australia has the lowest entry and discharge fees and the highest early termination fees. However, the difference in termination fees between Australia and the UK is attributable to the regulatory regimes operating in each country.[65]

4.79 ASIC found that where there is prevalence for refinancing, consumers could be disadvantaged with increases in higher fees and interest rates. Interestingly, ASIC also found that 'approximately two-thirds of refinancing in Australia involves no change of lender'.[66]

4.80 In Australia, consumers are faced with a complex raft of home loan products described in different ways, often creating difficulty[67] and confusion. Compared with the UK, Australia does not have a 'standardised nomenclature for the features of these products, particularly the fees.'[68]

63 Australian Securities and Investments Commission, Report 125: *Review of mortgage entry and exit fees*, April 2008, p. 21.

64 Australian Securities and Investments Commission, Report 125: *Review of mortgage entry and exit fees*, April 2008, pp. 10 and 16.

65 Australian Securities and Investments Commission, Report 125: *Review of mortgage entry and exit fees*, April 2008, p. 11.

66 Australian Securities and Investments Commission, Report 125: *Review of mortgage entry and exit fees*, April 2008, p. 13.

67 Australian Securities and Investments Commission, Report 125: *Review of mortgage entry and exit fees*, April 2008, p. 15.

68 Australian Securities and Investments Commission, Report 125: *Review of mortgage entry and exit fees*, April 2008, p. 15.

The impact of mortgage entry and exit fees on switching and competition

4.81 Consumers will only face the prospect of an exit fee when they choose to terminate their loan early. Depending on the saving that may be acquired versus the cost of the exit fee, consumers may decide not to switch to a better deal. This in turn would lock a consumer into a particular loan with a financial institution and where this situation is reproduced on a large scale in turn would negatively affect competition in the sector.[69]

4.82 ASIC found that exit fees range from $400 to just under $6,000 depending on the type of credit provider and in some cases exceeds this amount.[70]

4.83 The Consumer Action Law Centre (CALC) highlighted a recent case where one consumer did not switch to a better value mortgage because of the $14,000 exit fee that would have been incurred on switching.[71]

4.84 The RBA stated that the structure of Australia's mortgage fees was no better or worse than in other countries.

> … by international standards we have relatively high exit fees on mortgages but we have very low entry fees. That is just the way in which banks price things here. There are advantages and disadvantages in both systems.[72]

4.85 Further, the RBA stated that the mortgage fee structure operating in Australia is not an impediment to switching between mortgage providers. The RBA stated:

> …on international standards we have quite low loan establishment fees and we have relatively high exit fees. If you reduced the exit fees I do not think it would be unreasonable to assume that the entrance fees would rise. Ultimately, banks have to cover the cost of establishing the loan during the credit assessment origination and doing the legal work. In Australia they say to the borrower, 'At the beginning of the loan we will not charge you for those costs,

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69 Ms E Freeman, CHOICE, *Transcript*, 21 August 2008, pp. 75-76.

70 Australian Securities and Investments Commission, Report 125: *Review of mortgage entry and exit fees*, April 2008, p. 9.

71 Ms N Rich, Consumer Action Law Centre, *Transcript*, 8 August 2008, p. 21.

72 Mr R Battellino, RBA, *Transcript, 14 August 2008*, p. 14.

> but if you leave us within a short period we will recoup those costs.' For some reason they were not able to do that. I do not think it is unreasonable that they would increase the loan establishment fees, which you would then have to pay if you went to the new borrower. I do not think that is an issue here because you will either pay it at the beginning or you will pay it at the end. If you switch you cannot pay it at the end; you will pay it at the beginning for the new lender. I do not really see that as a major issue. If you take the sum of the loan establishment fees and the exit fees, you find that, broadly speaking, they are in line with what we see overseas.[73]

4.86 ANZ made the point that the deferred establishment fee has not limited refinancing with new providers. ANZ stated:

> The prevalence of the deferred establishment fee in the mortgage market has not restricted the ability of customers to refinance to new providers. This is shown in data from the Australian Bureau of Statistics, which suggests that the proportion of all loans advanced accounted for by refinancing has remained around 30 per cent per month since August 2003.[74]

4.87 The RBA reiterated that significant switching is taking place adding that consumers' switch based on differences in interest rates rather than fees. Banks are conscious of this and concentrate their interest rates 'around a very narrow range' as a result.[75]

4.88 Treasury made the point that regulating entry and exit fees cannot improve competition, but rather competition can be improved through an informed consumer.

> … at the end of the day we want to get the best result for the consumer. Oftentimes regulation distorts markets and does not get the best result for the consumer. We have looked at a chart showing each of the banks' rates and tried to work out what is more competitive and what is a better price on these mortgages. The point is whether the consumers really understand what they are getting into. You would hope when

73 Mr R Battellino, RBA, *Transcript, 14 August 2008*, p. 14.

74 Mr M Rowland, ANZ, *Transcript*, 8 August 2008, p. 38.

75 Mr R Battellino, RBA, *Transcript, 14 August 2008*, p. 18.

> you are signing up for a mortgage, which is a substantial commitment, you really understand the fees and charges.[76]

4.89 Treasury added that a consumer should look at the whole loan package to ascertain whether they are getting the better deal. Treasury noted work undertaken by CANNEX and commented that it 'found that some products that did charge exit fees were actually better overall in their ratings compared to some that did not because of the balance of all the different features. It is not necessarily in fact that a product with an exit fee is not competitive or not a good product for a consumer.'[77]

4.90 Abacus advocated providing consumers with clear, upfront information would be beneficial.

> … we think that having a clear and upfront comparable outline of what fees you would incur in a number of set standard circumstances and bringing that forward in terms of disclosure for consumers would be a very beneficial outcome, and it would bring those issues that no-one wants to think about, with regard to things going wrong or trying to move later, to the forefront of the decision-making process.[78]

The social impact of entry and exit fees

4.91 The Consumer Credit Legal Centre of New South Wales (CCLC) drew attention to the hardship faced by financially vulnerable consumers. CCLC argued that a combination of the continuing US sub-prime crisis and Australia's lack of regulation relating to predatory lending were to blame.[79]

4.92 CCLC put the case that the lack of comprehensive regulation in relation to lending has allowed 'predatory lending to thrive at the fringes'.[80] This has encouraged practices where loans are targeted at financially vulnerable groups and are then loaded up with fees making repayment impossible. CCLC stated:

> This practice, sometimes referred to as equity stripping, involves luring potential borrowers in financial difficulty with the unrealistic promise of saving their home, placing

76 Mr J Murphy, Treasury, *Transcript, 14 August 2008*, p. 35.

77 Ms S Bultitude, Treasury, *Transcript, 14 August 2008*, p. 36.

78 Ms L Petschler, Abacus Australian Mutuals, *Transcript*, 21 August 2008, p. 7.

79 Consumer Credit Legal Centre, *Submission no. 33*, pp. 14-15.

80 Consumer Credit Legal Centre, *Submission no. 33*, p. 16.

> them in expensive loans on which they are destined to default and loading up the loan with tens of thousands of dollars of set-up and default costs, which are realised at the almost inevitable sale of the home.[81]

4.93 CHOICE stated that, in addition to such examples, because of interest rate rises some exit fees have almost tripled.[82]

4.94 The Wesley Mission found that the price of loan products did not necessarily drop when there was a decrease in the cost of funding for financial institutions. This was also contributing to the inequality faced by consumers.

> When I was a boy in a different country, when the chip shop put up the price of chips it was always argued: 'That's because the new potatoes have come in. They have to go up.' But when the new potatoes finished and we were back on the old the price never came down. I think that I learnt something about social justice through that that follows through in this whole area too. If in fact the cost of the money that is available to the banking institutions has dropped, it seems to me that to not pass it on, knowing that we face insuperable debt problems and social issues in Australia, is a case of injustice, and it has to be addressed—and it has to be addressed very soon.[83]

4.95 The Credit Ombudsman also highlighted the trap that people who are 'desperate' to purchase a home often fall into with entry and exit fees. In particular, the availability of high cost loans to those who may not wholly be able to afford a mortgage.

> One thing that we have noticed is that if someone wants a loan they will get it. There is no doubt about it. We see a lot of cases where people are quite desperate for a loan. We do have cases where the broker has actually said, 'You are not ready for this loan; don't touch it' and they move on to someone else. It is understandable that when someone is worried about the sheriff knocking on the door that they will try to refinance the loan. It is probably the worst thing they can do, because at the end of the day the repayments will be higher and the

81 Consumer Credit Legal Centre, *Submission no. 33*, p. 16.

82 Ms E Freeman, CHOICE, *Transcript*, 21 August 2008, p. 76.

83 Rev Dr K Garner, The Wesley Mission, *Transcript*, 21 August 2008, p. 56.

> costs will be higher because of the exit and entry fees and higher interest rates et cetera.[84]

4.96 The Credit Ombudsman identified consumers' financial illiteracy as a contributing factor to the financial hardship experienced by some consumers who enter into unsuitable loan arrangements.

> I suspect this is the whole problem. We are not financially educated in Australia through our school system. We see very often that we are dealing with people who have no idea how to read a bank statement. A lot of our complaints are as a result of people misunderstanding the processes, misunderstanding how things work in the conveyancing process and misunderstanding how things were calculated and things like that. So, to answer your question, I suspect that a number of people do not read their contracts, do not care to read them or do not understand them.[85]

Regulation of entry and exit fees

The Uniform Consumer Credit Code

4.97 In Australia, household lending is regulated through the Uniform Consumer Credit Code (UCCC). The UCCC does not 'apply to lending for the purchase of investment properties', so while the UCCC regulates the 'relationship between a borrower and lender' it does not apply to intermediaries such as mortgage and finance brokers.[86]

4.98 The UCCC allows for the imposition of fees and charges as long as they are 'authorised by, and disclosed in, the [mortgage] contract'. Exit fees are covered by section 72 of the UCCC which provides for the imposition of 'reasonable and proportionate fees or charges… to reflect the loss that credit providers suffer'.[87]

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84 Mr R Venga, Credit Ombudsman, *Transcript*, 21 August 2008, p. 45.

85 Mr R Venga, Credit Ombudsman, *Transcript*, 21 August 2008, p. 46.

86 Australian Securities and Investments Commission, *Report 125, Review of Mortgage entry and exit fees*, April 2008, p. 21.

87 Australian Securities and Investments Commission, *Report 125, Review of Mortgage entry and exit fees*, April 2008, p. 21.

4.99 In addition to the UCCC, ASIC under its establishing Act 'has limited jurisdiction in relation to credit, but does not regulate disclosure in relation to mortgage products.'[88]

4.100 ASIC found that the UCCC is applied so that the sum of entry and exit fees is not required to be disclosed to the consumer at the time of entering into a loan contract.

> This disclosure regime appears to envisage a situation where the method of calculation of a fee payable under the loan contract, for example an early termination fee, is not ascertainable and therefore not able to be disclosed at the time of contracting.[89]

4.101 This includes that credit fees or charges and exit fees are not included in the mandatory comparison rate (which is included under Part 9A, Division 2 of the UCCC to 'assist consumers to identify the true cost of credit').[90]

4.102 ASIC noted that under section 72 of the UCCC, entry and exit fees are 'subject to challenge by the debtor or guarantor on the grounds that they are unconscionable'.[91]

4.103 To date only one case has tested the notion of 'unconscionability' as it applies to establishment fees (*Director of Consumer Affairs Victoria v City Finance Loans and Cash Solutions (2008), VCAT*). Justice Morris ruled that 'there is no implied obligation to refrain from charging an unconscionable establishment fee, rather, that a lender is at risk if it charges an unconscionable establishment fee.'[92]

4.104 ASIC suggested that there may not have been further cases testing 'unconscionability' as under the UCCC, state government consumer agencies have no power to make applications in relation to establishment or early termination fees.[93]

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88 Australian Securities and Investments Commission, *Report 125, Review of Mortgage entry and exit fees*, April 2008, p. 23.

89 Australian Securities and Investments Commission, *Report 125, Review of Mortgage entry and exit fees*, April 2008, p. 22.

90 Australian Securities and Investments Commission, *Report 125, Review of Mortgage entry and exit fees*, April 2008, p. 23.

91 Australian Securities and Investments Commission, *Report 125, Review of Mortgage entry and exit fees*, April 2008, p. 22.

92 Australian Securities and Investments Commission, *Report 125, Review of Mortgage entry and exit fees*, April 2008, p. 23.

93 Australian Securities and Investments Commission, *Report 125, Review of Mortgage entry and exit fees*, April 2008, p. 23.

Improving regulation

4.105 Interestingly, the Credit Ombudsman examined the issue of high mortgage exit fees through the Consumer Credit Code and found that in most cases high exit fees were justifiable because of the lack of economies of scale for smaller mortgage providers.[94]

4.106 The Credit Ombudsman advocated standardising the financial terminology used as a way for improving financial literacy.[95] The Wesley Mission[96] and CHOICE[97] reiterated this view. This issue is addressed in the following chapter.

4.107 Abacus questioned the high rates of some exit fees and has recommended that they be examined as barriers to switching.

> …it is difficult in some instances with those higher fees to see that there is a reasonable basis for them being charged at the levels that they are at. And we would encourage regulators to have a look at whether some of those fees and charges might be moving into the unconscionable realm. We think there are some opportunities to look at high-end fees where they are in our view operating as a definite brake on the ability of consumers to leave, particularly if you are looking at fees in some instances close to $10,000. That is a significant competitive brake.[98]

4.108 To combat any unfair lending practices, CCLC advocated implementing a 'comprehensive regulatory framework for all types of lending.' This would include 'licensing and conduct provisions and compulsory external dispute resolution.'[99]

4.109 CCLC argued that this approach would empower regulators 'to identify and exclude predatory conduct and other inappropriate conduct or product innovations that create unhealthy competitive pressure to decrease lending standards.'[100]

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94 Mr R Venga, Credit Ombudsman, *Transcript*, 21 August 2008, p. 45.
95 Mr R Venga, Credit Ombudsman, *Transcript*, 21 August 2008, p. 47.
96 Dr K Garner, The Wesley Mission, *Transcript*, 21 August 2008, p. 57.
97 Ms E Freeman, CHOICE, *Transcript*, 21 August 2008, p. 76.
98 Mr M Degotardi, Abacus, *Transcript*, 21 August 2008, p. 8.
99 Consumer Credit Legal Centre, *Submission no. 33*, p. 16.
100 Consumer Credit Legal Centre, *Submission no. 33*, p. 16.

4.110 CHOICE supported 'the introduction of unfair contract laws in the consumer credit market' as a way of 'challenging high early exit fees'.[101]

4.111 Since August 2007, the Ministerial Council on Consumer Affairs has been investigating, consulting and considering amendment to the UCCC. Amendments under consideration would allow for:

- review of interest, fees and charges;
- the ability of courts to take into account 'the objective of reasonableness of costs incurred in establishing or terminating a loan' where applicable;
- the term 'unconscionable' would be replaced with 'unreasonable'; and
- Government consumer agencies would be granted 'standing to represent the public interest, or individual debtors or groups of debtors.'[102]

4.112 Further, research has been commissioned 'into pre-contractual disclosure with the goal of developing a new disclosure model better addressing the needs of consumers'.[103]

4.113 Other areas where reviews and or changes have been suggested include: to unfair contract terms, mandatory comparison rates and the regulation of finance brokers and credit providers.

4.114 In addition to these, in December 2007, the Productivity Commission released a draft report on Australia's Consumer Policy Framework. The report suggests that government take responsibility for finance brokers and finance providers through adoption of the UCCC including the introduction of a 'licensing system for finance brokers and registration system for credit providers.'[104]

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101 Ms E Freeman, CHOICE, *Transcript*, 21 August 2008, p. 76.

102 Australian Securities and Investments Commission, *Report 125, Review of Mortgage entry and exit fees*, April 2008, p. 26.

103 Australian Securities and Investments Commission, *Report 125, Review of Mortgage entry and exit fees*, April 2008, p. 26.

104 Australian Securities and Investments Commission, *Report 125, Review of Mortgage entry and exit fees*, April 2008, p. 27.

Conclusions

4.115 The committee is uncertain whether there is a definite, across the board, negative impact on competition caused by the imposition of entry and exit fees on mortgage products.

4.116 The committee finds that it cannot draw this conclusion because different financial providers have very different financial products on offer, which may have either a high entry fee or a high exit fee. In the current financial environment, consumers are likely to be hit by either if switching.

4.117 The committee finds that the issue is complicated further as in the pre-implementation period of the Switching Package there is a high level of switching from one mortgage provider to another. The committee believes that the impact on competition will be evident only after the Switching Package has been in operation for a minimum of 12 months.

4.118 The committee was concerned at the level of fees that credit providers may 'reasonably' charge, which can lead to and has in certain circumstances lead consumers to default on their loan and lose their home. More disturbing is the fact that under the present regulatory environment, credit providers may have targeted vulnerable consumers creating consumer financial hardship.

4.119 The committee acknowledges that there is community concern about the current level of entry and exit fees on some mortgage products.

Recommendation 8

4.120 **The committee recommends that, as part of the adoption of responsibility for the regulation of credit and the introduction of a national consumer policy framework, the government consider mechanisms for making entry and exit fees more transparent and for addressing unfair entry and exit fees.**

5

Consumer protection for borrowers

Introduction

5.1 Robust consumer protection is vital for consumer confidence. Consumers need to be able to obtain appropriate information and disclosure if they are to effectively compare and chose products. The Bank of Western Australia (BankWest) stated:

> Consumers are more likely to shop around for products from a range of financial services providers if they are confident that they are dealing with reputable organisations and will have sufficient protection afforded them.[1]

5.2 The banking and non-banking industry relies heavily on disclosure to drive competition. Competition could be enhanced if better disclosure requirements existed at the point of purchase.

5.3 There is a wide range of products provided by the banking and non-banking sectors. The range currently available has significantly increased over the last ten to fifteen years. With such a wide range of products to choose from, it can be complicated and difficult for consumers to compare financial products.

5.4 Consumers need to have access to quality advice to enable them to make the right choices for their circumstances. Without adequate protections, consumers may receive inappropriate advice in relation

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1 Bank of Western Australia Ltd, *Submission no. 29*, p. 8.

to mortgages and investment loans. Bad advice can lead to excessive levels of debt being taken on by consumers. In situations where interest rates and/or unemployment start rising, consumers who have taken on inappropriate levels of debt risk defaulting on payments and possible repossession. This pattern has an immediate impact on the families concerned and can also lead to financial instability as demonstrated by the US sub-prime crisis.

5.5 Effective disclosure regimes must be in place to ensure that an industry with a wide range of products is competitive. Additionally, where desired, consumers must have access to appropriate professional advice. The West Australian Department of Consumer and Employment Protection stated:

> Consumers have varying degrees of functional and financial literacy and even with effective disclosure regimes in place, some consumers may require professional advice as to the best loan products for their circumstances. This is especially the case as loan products become more complex and are increasingly interrelated with other financial products (including credit cards and offset accounts), investment options (including shares and real estate) and broader financial plans.[2]

5.6 However, some consumers struggle to understand the complexity of products on offer because information about products is not given in the way many potential customers assess products. The Brotherhood of St Laurence noted that:

> …market research shows that low-income people are more likely to assess affordability in terms of fortnightly loan repayments than interest rates and fees which are typically promoted.[3]

5.7 This chapter looks at various aspects of consumer protection in relation to the banking and non-banking industry, including Commonwealth regulation; mortgage brokers; financial literacy; how consumers can compare products; and disclosure requirements.

2 Department of Consumer and Employment Protection, Government of Western Australia, *Submission no. 38*, p. 6.

3 Brotherhood of St Laurence, *Submission no. 21*, p. 3.

Progress with Commonwealth regulation of credit

5.8 Responsibility for consumer protection in relation to consumer credit, including mortgages, is currently shared between the Australian Government (regulated by Australian Securities and Investments Commission (ASIC)) and the state and territory governments, through their respective Fair Trading Offices.

5.9 In September 2007, in its report *Home loan lending: Inquiry into home loan lending practices and the processes used to deal with people in financial difficulty*, the committee recommended that 'the Commonwealth Government regulate credit products and advice. This includes the regulation of mortgage brokers and non-bank lenders'.[4]

5.10 Following the committee's recommendation, in July 2008, the Council of Australian Governments (COAG) reached agreement that the Commonwealth Government would assume responsibility for regulation of all consumer credit. COAG also formally agreed that the Australian Government would assume responsibility for regulating mortgages, mortgage brokers, trustee companies, non-bank lenders and margin loans, for the purpose of protecting consumers.

5.11 Following the July agreement, in October the Commonwealth Government was consulting with the states and territories to develop a plan to present to COAG on how the new agreement will be implemented.

5.12 The response by the Commonwealth Government to assume responsibility for regulation of consumer credit was welcomed by many stakeholders. For example, the Australian Bankers' Association (ABA) believes that, among other benefits, this decision will help to protect consumers from unequal treatment. It stated:

> The ABA has publicly welcomed the decision…to move the regulation of credit from the states to the federal sphere. …This will deliver efficiency benefits in addition to providing consumer safeguards against poor practices and ensuring customers are treated equally regardless of where they reside or where they undertake transactions.[5]

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4 House of Representatives Standing Committee on Economics, Finance and Public Administration, *Home loan lending: Inquiry into home loan lending practices and the processes used to deal with people in financial difficulty*, September 2007, p.49.

5 Australian Bankers' Association Inc., *Submission no. 26* , p. 24.

5.13 Abacus, the Association of Building Societies and Credit Unions, noted that:

> A national framework will improve consumer protection and create a level playing field for credit providers…but we seek a regime that minimises compliance costs for ADIs.[6]

5.14 The Commonwealth Government's decision to assume responsibility for regulation of consumer credit is a positive step towards ensuring improved and adequate consumer protection for borrowers.

Mortgage brokers

5.15 In September 2007, this committee published a report which looked in detail at regulation of mortgage brokers.[7] This section examines the relationship between the mortgage broker and the consumer.

5.16 There is evidence that consumers value the services of mortgage brokers. Consumers' demand for advice on loan products has driven the increasing number of home loans arranged by finance brokers in recent years.[8] In 2003, twenty-five per cent of home loans were originated by mortgage brokers and by 2008, 'around thirty-five per cent of loans in Australia originated through the broker channel'.[9]

5.17 Australia is one of the few, if not the only country where trailing commissions are an intrinsic part of the broker commission structure and 'many brokers have built a very significant business on these trailing commissions'.[10] The commission structure that applies to mortgage brokers can be explained as follows, using a $250,000 loan as an example, as detailed by Fujitsu Consulting:

> An upfront commission is paid, which is between 0.65 per cent and 0.85 per cent of the loan value on day one. Then there is a trailing commission paid for each subsequent year that the loan is on the book, and that is between 0.15 per cent

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6 Abacus Australian Mutuals, *Submission no. 42,* p. 8.

7 House of Representatives Standing Committee on Economics, Finance and Public Administration, *Home loan lending. Inquiry into home loan lending practices and the processes used to deal with people in financial difficulty,* September 2007, p. 39-49.

8 Department of Consumer and Employment Protection, Government of Western Australia, *Submission no. 38,* p. 6.

9 Fujitsu Consulting, *Submission no. 9,* p. 3.

10 Mr J North, Fujitsu Consulting, *Transcript*, 15 August 2008, p. 30.

> and 0.25 per cent. …It is quite hard to be able to convert that into a single dollar number. Most of the brokers will be more attracted by the upfront commission, so they will be doing a quick calculation based on 0.6 per cent or 0.7 per cent of $250,000.[11]

5.18 However, although 'consumers believe they obtain "objective and independent advice" from brokers'[12] there is a disconnect between consumer expectations and broker behaviour. Fujitsu notes:

> The broker is not the agent of the consumer, nor the bank, and there is no obligation to provide best advice to consumers.[13]

5.19 Fujitsu Consulting recommended that revised regulation of brokers in Australia is required to protect consumers. The relationship between the mortgage broker, the consumer and the lender needs to be defined:

> …the right option is to make the broker the agent of the consumer and to impose an obligation of providing best advice to consumers. This would have significant benefits in terms of sharpening competitive tension in the industry, reducing the potential for predation, and defining the scope of disclosure. [14]

Should the customer pay the broker?

5.20 Evidence gathered over the course of the inquiry indicated that many people who speak to a broker believe that the broker will be providing advice to them in their best interests but this may or may not be the case. Some confusion exists as to whether brokers owe an obligation to the consumer or to the lender.

5.21 Fujitsu Consulting's research highlights that brokers tend to recommend loans from a small selection of panel lenders, maybe only three or four even if there is a broader range available, and brokers are heavily influenced by the commissions they receive. In a survey of ten per cent of brokers, Fujitsu found that:

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11 Mr J North, Fujitsu Consulting, *Transcript*, 15 August 2008, p. 30.

12 Fujitsu Consulting, *Submission no. 9*, p. 3.

13 Fujitsu Consulting, *Submission no. 9*, p. 6.

14 Fujitsu Consulting, *Submission no. 9*, p. 7.

> …the upfront commission was the most significant element in influencing choice of lender. …This means that consumers may not be always getting the "objective and independent advice" they expect. [15]

5.22 Some witnesses disputed the allegation that brokers are influenced by the commissions they receive. The Mortgage and Finance Association (MFAA) stated:

> Until recently the commissions that have been available to [brokers] from lenders have been so similar that it would be hardly worth your while to recommend one rather than the other for the sake of a small difference in commission. Our members tell us the driving forces for recommending a particular lender are the service they provide and how quickly they approve the loan. …The driving force is to get a response quickly about whether or not the loan is approved. The lender who is first to approve the loan is the one that will get the business.[16]

5.23 Fujitsu Consulting, citing the United Kingdom where brokers are increasingly providing independent advice for a fee, suggested that the right model for best advice for Australia would be where brokers receive a payment from the consumer for advice, rather than a commission from a lender:

> It is difficult to envisage a situation where commissions if paid will not influence the advice. There is a question whether full disclose of commissions, including soft commissions and quotas are sufficient. In the UK, the proportion of Brokers who provide independent advice for a fee are rising. Brokers can choose this model, or be tied to lenders, in which case they cannot claim to provide best advice. [17]

5.24 Recent changes in Australia have seen both the major and minor lenders 'changed their commission structure considerably downward'[18]. The MFAA stated:

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15 Fujitsu Consulting, *Submission no. 9,* p. 4.

16 Mr P Naylor, Mortgage and Finance Association of Australia, *Transcript*, 14 August 2008, p. 50.

17 Fujitsu Consulting, *Submission no. 9,* p. 7.

18 Mr P Naylor, Mortgage and Finance Association of Australia, *Transcript*, 14 August 2008, p. 50.

> …brokers are looking at the idea of saying to consumers, 'We think we can add value to the process and we think that you should pay a fee for our services.' I think that will evolve, rather than happen overnight. [19]

5.25 Aussie Home Loans agreed that if customers paid a fee to brokers instead of brokers receiving a commission from lenders, the system would be a lot more transparent, however, it notes:

> …the fee would have to be a very significant fee to take into account the costs of your staff, valuations, costs, legal costs on the documentation, and the cost of running an operation.[20]

5.26 If brokers no longer received commission from lenders but were paid directly by the consumer, this would reduce the number of mortgage brokers in the industry. In the United Kingdom half the brokers left the industry within 18 months of regulation effecting this change. Fujitsu Consulting expects the number of mortgage brokers in Australia to fall 'from 11,000 to 6,000' if such regulation was enacted. [21]

5.27 If brokers were to start charging the loan seeker a fee, borrowers who are least able to pay could be disadvantaged and many would have no option but not to use a broker. The MFAA stated:

> A lot of borrowers who go to brokers are people who are not in the position of having extra cash to pay fees. The danger in that potentially is that a broker who has been dealing with borrowers who are borrowing medium or small loans but who do not have any extra cash to pay fees will be disqualified from the broker process. That is something the industry will have to work through.[22]

5.28 There was some discussion about the possibility of a grant being included as part of the first-time homeowner's grant for the specific purpose of allowing borrowers to seek financial advice. Fujitsu said:

> I would make it such that you could get an additional $300 or $400 from that [the first-time homeowner's] grant. …I can tell you that the scary thing for me…is how little they understood about what they were getting into. I genuinely believe that

19 Mr P Naylor, Mortgage and Finance Association of Australia, *Transcript*, 14 August 2008, p. 50.

20 Mr J Symond, Aussie Home Loans, *Transcript*, 14 August 2008, p. 60.

21 Fujitsu Consulting, *Submission no. 9,* p. 8.

22 Mr P Naylor, Mortgage and Finance Association of Australia, *Transcript*, 14 August 2008, p. 50.

> having better conversation up front, even if it is subsidised through the grant, would actually protect them and give them a better foundation to make the right decision and it would do all the positive things.[23]

Conclusions

5.29 Mortgage brokers may not always act in the best interests of the customer if they are working on commissions from lenders. Fujitsu Consulting proposed that mortgage brokers should be paid by the customer rather than the lender. This would help to ensure that mortgage brokers acted in the best interests of their client. Mortgage brokers generally receive an upfront commission and a trailing commission from a lender. These charges are not insignificant and many customers could not afford to pay these types of commissions. It was suggested in evidence that part of the first home buyers grant could be used by customers to pay mortgage brokers. However, many people seeking advice from a broker may not be entitled to the first home owner’s grant and, therefore, if a new regulation was to force customer’s to pay for advice up front, then these people may choose not to use a broker.

5.30 The committee notes that the Mortgage Finance Association believes that a system will evolve, and is in fact already evolving, that will result in two types of brokers: those who offer advice for a fee and who will be independent of lender’s commissions, and brokers who will continue to charge no fee to the customer but will work on lender’s commissions. Customers would be free to choose which type of broker suits their needs best.

Financial literacy

5.31 Consumers who are financially literate are better able to make effective and informed decisions about how they manage their money and, in the case of borrowing, about which products are most suited to their needs and their ability to repay.

5.32 Many consumers of banking and non-banking products, however, have low financial literacy and consequently, according to the Finance Sector Union:

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23 Mr J North, Fujitsu Consulting, *Transcript*, 15 August 2008, p. 30.

> …there is a great need for this country, the banks in particular, to fund an increase in financial literacy education, as 90 per cent of the people in this country do not even understand what compound interest means. A number of people that we deal with and that we know financial counsellors deal with do not understand the consequences of what they are doing.[24]

5.33 People with a low level of financial literacy are more vulnerable to predatory lending. Predatory lending results in consumers being sold the wrong loans. Fujitsu Consulting explained that predatory practices can include:

- Excessively high set up costs, especially if financed as part of the loan;
- Excessive advice fees;
- Pressure to sign the documentation without proper explanation;
- High ongoing interest rates;
- Embedded conditional fees which are not transparent;
- Consumers advised to make false declarations on application forms (for example overstating income); and
- Pressure to refinance. [25]

5.34 To augment general financial literacy and better protect consumers against predatory lending, the Wesley Mission recommended that financial education in schools and beyond is needed:

> …at all different levels of the life cycle: in school, as young families are beginning to think about their future, and right through the cycle. …financial literacy education should be oriented to providing individuals with skills and tools to detect early warning triggers when there are financial difficulties—not just how do you handle a budget, but how do you handle a crisis when it happens.
>
> We recommend that measures to improve financial literacy should adopt a whole-of-life approach at appropriate stages.[26]

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24 Mr L Carter, Finance Sector Union, *Transcript,* 19 September 2008, p. 46.

25 Fujitsu Consulting, *Submission no. 9,* p. 5.

26 Rev Dr K Garner, Wesley Mission, *Transcript*, 21 August 2008, p. 51.

5.35 There have been various initiatives by stakeholders to raise financial literacy in Australia over the last few years. For example, the Finance Sector Union provides a financial literacy program free of charge to anybody who wants it, however, it believes that financial literacy:

> …should be included in the teaching of reading and writing at primary and secondary school level. …just in the last 10 years, …certainly our innate level of financial literacy has declined. …We would love to see the consumer being educated to the point where they make an informed choice.[27]

5.36 Another initiative is the Australian Financial Literacy Assessment – a free and voluntary national online assessment available to Australian students in Years 9 and 10. It is an initiative of the Commonwealth Bank Foundation and is developed and delivered by Educational Assessment Australia. The Australian Financial Literacy Assessment is available online for Year 9 and Year 10 students and is designed to benefit student learning across a number of disciplines.[28]

5.37 The ANZ bank has also invested funds over many years in the area of financial literacy and consumer education and stated:

> …financial literacy is a very important aspect in empowering consumers to make the market work better. It is important because, since financial deregulation, things have got lots more complex than they used to be. …'empowered consumers' are very good for keeping we banks on our toes. …A financially literate consumer in conjunction with a good and sensible regulatory framework is the right way to go.[29]

5.38 The Brotherhood of St Laurence made the observation, based on its work in the community, that while financial literacy is important, it needs to be offered in conjunction with financial inclusion programs. It stated:

> …we are concerned that financial literacy can blame the victim a bit. It can be seen as saying, 'If we just give them the skills that will be okay.' Giving people the skills to work in a system that is excluding them and offers inappropriate products for them is probably of limited use. We would not want too much emphasis on financial literacy as the solution

27 Mr L Carter, Finance Sector Union, *Transcript,* 19 September 2008, p. 46-7.

28 http://www.eaa.unsw.edu.au/afla

29 Ms J Nash, ANZ Bank, *Transcript*, 8 August 2008, p. 41.

> but, certainly, insofar as it helps low-income people to be able to navigate the system, it is important.[30]

5.39 In 2005 the federal government responded to a perceived need for improved financial literacy among borrowers when it established the Financial Literacy Foundation.[31] The aim of the foundation was to give all Australians the opportunity to increase their financial knowledge and better manage their money.

5.40 On 1 July 2008, the functions of the Financial Literacy Foundation were transferred to ASIC. Following its transfer to ASIC, the Financial Literacy Foundation has been working with all state and territory education authorities to have financial literacy included in the curriculum for Years K-10 from 2008 onwards.

5.41 Extensive information about the Financial Literacy Foundation can be found on the Understanding Money website.[32] This website is separate from the consumer website of ASIC, which is known as FIDO (financial tips and safety checks).[33]

5.42 The committee heard from the Treasury that the government is currently trying to 'ensure that there is better information put before people'[34] to enable people to understand the products which are available. Documentation relating to financial transactions is being simplified and standardised. Treasury stated:

> This government is moving to try to standardise and simplify documentation that people will use when they are entering into financial transactions. The first step along the way has been this first home owners' scheme. They have standardised some very simple documentation and now the government … is looking at trying to track that across the board.[35]

5.43 Discussing its ideas for the development of an industry-wide set of standards, the Council of Mortgage Lenders suggested that 'standardised industry-wide information packs' would be an integral

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30 Ms G Sheehan, Brotherhood of St Laurence, *Transcript*, 8 August 2008, p. 63.

31 The Financial Literacy Foundation website can be accessed at: http://www.understandingmoney.gov.au/

32 Australian Government 'Understanding Money Website' viewed on 9 October 2008, <http://www.understandingmoney.gov.au/Content/Consumer/About/aboutflf.aspx>

33 ASIC consumer website can be accessed at: http://www.fido.gov.au/fido/fido.nsf

34 Mr J Murphy, Treasury, *Transcript*, 14 August 2008, p. 39.

35 Mr J Murphy, Treasury, *Transcript*, 14 August 2008, p. 38.

part of an overall set of standards which 'would allow consumers to make informed decisions about lending'.[36]

Conclusions

5.44 The committee supports the goals and objectives of the Financial Literacy Foundation and encourages it to build on the work it has already done.

5.45 Furthermore, the committee believes it could be most useful to people who are trying to understand the products which are available if there were a glossary of standardised financial terms in very simple language. This glossary could be placed on both the ASIC consumer website and the Understanding Money website.

Recommendation 9

5.46 **The committee recommends that the Australian Securities and Investments Commission includes a glossary of standardised financial terms in simple language on its consumer website and also on the Financial Literacy Foundation's website.**

Predatory practices relating to credit cards

5.47 It is common practice for banks and non-banks to send unsolicited offers of increased credit limits to customers holding credit cards. These offers often result in people with low financial literacy increasing credit limits on their credit cards without fully understanding the implications and which, in many cases, they have no way of repaying. The Consumer Action Law Centre pointed out the contradictory practice of many banks which are:

> …putting very bland information on their website about how to use credit responsibly and then sending something out to a pensioner saying, 'Increase your credit limit in the next two weeks—this is a short offer.'[37]

36 Mr P James, Council of Mortgage Lenders, *Transcript*, 14 August 2008, p. 72.

37 Ms C Bond, Consumer Action Law Centre, *Transcript*, 8 August 2008, p. 27.

5.48 The Consumer Action Law Centre recommended that lenders should be obliged, at the time they are providing the credit, to assess whether the individual can repay the increased amount. It cited several examples of clients who have been pushed to take on higher credit limits even though they would struggle to repay the credit, stating:

> …we have a couple of clients at the moment who have been on pensions for many years but have been receiving letters saying, 'Congratulations, you're pre-approved for more credit, for more credit, for more credit'. Their loans are both bank loans, and they have taken these people to over $30,000. In both cases, we are involved because we are concerned that their home is at risk. They are not isolated cases. We had someone ring us recently who said he went to apply for interest-free credit. He only wanted a fridge for $800, but the company sent him a credit card for $10,000. It then sent him letters urging him to use that credit—at 28 per cent, mind you. …We are seeing an increase in that sort of marketing. Those lenders in many cases are not really assessing whether the person has the ability to pay.[38]

5.49 The Wesley Mission related similar stories of hardship caused by easy access to credit which cannot be repaid, telling the committee:

> Through overly easy access to credit—personal loans, financing or credit cards—many of our clients in counselling services at Wesley Mission face the burden of loans that they can never pay back. When we have done our research, we have discovered people with handfuls of credit cards, almost like a pack of cards, and all of that raises questions about the easy access to certain levels of credit without proper financial planning.[39]

5.50 Wesley Mission believes that more needs to be done to ensure that people with little or no financial literacy understand the implications of increasing their debt. It stated:

> The challenge for providers is to fully embrace the principle [of truth in lending] and provide accurate, complete and easily comprehensible financial information to all clients.

38 Ms C Bond, Consumer Action Law Centre, *Transcript*, 8 August 2008, p. 20.

39 Rev Dr K Garner, Wesley Mission, *Transcript*, 21 August 2008, p. 50.

That is, trustworthy, simple and non-biased financial information.[40]

Conclusions

5.51 The committee agrees that it is an undesirable practice for lenders to push people to increase their credit limits regardless as to whether or not those people are able to understand the implications of taking on more debt or if they will be able to repay the increased debt.

Recommendation 10

5.52 **The committee recommends that, as part of its adoption of responsibility for the regulation of credit, the government consider the feasibility of regulating unsolicited credit card limit increases.**

Sales targets and responsible lending

5.53 The Finance Sector Union of Australia noted its concern that sales targets for finance sector staff are increasingly used as the only way staff can access increased remuneration. All banks except 'some of the community banks'[41] – notably Bendigo Bank and St George – use a system of sales targets for staff which are 'designed to maximise sales which (even inadvertently) will lead to a higher risk of inappropriate sales occurring'.[42] Staff are under constant pressure to achieve sales which 'inevitably lead to some consumers being sold products that they may not be capable of repaying or even need'[43].

5.54 The Finance Sector Union recently surveyed 2,000 of its members who are predominantly in the established banking sector and found that:

- 52 per cent of workers felt obliged to try and sell debt products even when a customer didn't need them;

40 Rev Dr K Garner, Wesley Mission, *Transcript*, 21 August 2008, p. 52.

41 Mr L Carter, Finance Sector Union of Australia, *Transcript*, 19 September 2008, p.42.

42 Finance Sector Union of Australia, *Submission no. 39*, p. 5.

43 Finance Sector Union of Australia, *Submission no. 39*, p. 5.

- 63 per cent felt that inappropriate sales targets are having a negative impact on their ability to provide responsible customer service; and
- 59 per cent felt pressured to make inappropriate sales to meet sales targets.[44]

5.55 While the Finance Sector Union does not object to the principle of performance pay for meeting targets it believes that targets should only exist within a system based on guaranteed CPI increases. It stated:

> If wages for finance sector employees cannot go backwards, then the pressure to meet sales targets will inevitably be lower.[45]

5.56 There is currently no regulatory body which oversees the impacts of performance pay and sales targets for bank staff. The Finance Sector Union believes that there needs to be a regulatory regime which:

> …should enshrine some form of principles to mandate 'responsible lending' practices. The FSU believes that such measure would ensure 'healthier' competition in the finance sector. In line with this belief the FSU has been developing a draft "Charter of Responsible Lending".[46]

Conclusions

5.57 The committee believes that the Finance Sector Union has a legitimate concern. It is possible that performance pay could lead to customers being disadvantaged if they are pressured into taking on more debt than they are able to repay.

5.58 An implication has been made by the Finance Sector Union that consumers could be disadvantaged by financial services staff who are pressured to sell products which may be inappropriate for the purchaser's needs and therefore the committee believes that ASIC should be requested to examine these claims.

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44 Finance Sector Union of Australia, *Submission no. 39*, p. 5.

45 Finance Sector Union of Australia, *Submission no. 39*, p. 5.

46 Finance Sector Union of Australia, *Submission no. 39*, p. 5.

Consumer information to compare products

5.59 Consumers must have access to accurate, comprehensive, freely available information if they are to be able to compare banking products and ultimately chose the one which is most suitable to their needs and which they can afford over the long term.

5.60 Since the mid-1990s a range of tools to assist customers to compare the pricing and features of the available banking products have emerged. For example:

> …financial services research firms such as Infochoice and CANNEX provide searchable databases outlining the pricing and features of different banking products, and CANNEX also publishes reports that rate individual products against a range of key criteria.[47]

5.61 Some stakeholders, however, believe that the information published by some financial services research firms may not be giving consumers the full picture. Mates Rates Mortgages stated:

> Consideration should also be given to reviewing the appropriateness of advertising bureaus such as CANNEX, Money Magazine and Your Mortgage Magazine from promoting 'Best of' awards where these bureaus do not look beyond lenders that advertise with them.[48]

5.62 CHOICE told the committee that many products have become so complex that it is difficult for consumers to gain an adequate understanding of their features in order to compare one product with another:

> The mandatory comparison rate for loans is designed to address this problem. It is meant to give consumers a comparable snapshot of the total cost of competing loan products. But the rise and rise of exit fees, which are not included in the comparison rate, has rendered it less useful. We think it is time that the mandatory comparison rate gets an overhaul[49]

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47 Treasury, *Submission no. 32,* p. 11.

48 Mates Rates Mortgages, *Submission no. 22,* p. 8.

49 Ms E Freeman, CHOICE, *Transcript*, 21 August 2008, p. 76.

5.63 It would be helpful for consumers to compare products if all banks and non-banks used standardised forms giving the same information. The Commonwealth Bank noted:

> …it would be good to have clear structures around how you describe and explain fees and things so that for customers there is a clear and open, transparent sort of process to be able to understand what they are getting into.[50]

5.64 It seems that 'at the moment neither institutions nor consumers are well served by the very conservative and legalistic disclosures that consumers are provided with'.[51] Non-standardised and unclear information is preventing people from being able to shop around effectively because they cannot compare terms, conditions and costings easily.

5.65 Fujitsu Consulting is 'absolutely of the belief that there should be better documentation provided to consumers at the time they purchase a loan'. It stated:

> Let us say the average loan life in Australia is three years. I would say, 'If you hold this loan for three years, this is the total cost over that three-year period.' It is a bit like a mobile phone plan. It is a dollar amount. You could then compare deal A to deal B and deal C. You cannot do that today. Brokers, even with their online tools, cannot give you a completely watertight comparison.[52]

5.66 The United Kingdom has addressed the problem of documentation and the consumer's ability to compare products by producing a 'key facts document'. Fujitsu Consulting explained that, while the UK's version is 'probably a bit long':

> …it does articulate a few things. It says, 'This is why this loan is right for you. These are all of the features, benefits and costs of the loan.' I am providing this advice to you because I represent either a bank or I am giving you independent advice, and so there is clarity about the basis on which advice is given, and there is some standard comparison data in there as well. I think a key facts document would help. The trick

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50 Mr J Sheffield, Commonwealth Bank of Australia, *Transcript*, 25 September 2008, p. 24.

51 Ms L Petschler, Abacus Australian Mutuals, *Transcript*, 21 August 2008, p. 13.

52 Mr M North, Fujitsu Consulting, *Transcript*, 15 August 2008, p. 26.

> here is not to make it too long and complicated, otherwise you just increase the costs of writing the mortgages. [53]

Conclusions

5.67 The committee notes that Treasury has established a Financial Services Working Group comprised of officials from Treasury, the Department of Finance and Deregulation and ASIC. The group is seeking to improve product disclosure requirements to make it easier for consumers to make informed financial decisions and compare products. The Treasury working group is described in some more detail below.

5.68 The committee believes that, in addition to the work Treasury is doing to improve product disclosure, there is a need in Australia for some sort of standardised 'key facts document', similar to the UK model, to help consumers to compare effectively mortgage products.

Recommendation 11

5.69 **The committee recommends that the Treasury develop a standardised key facts document for mortgage products, based on the UK model, to help consumers to compare financial products. The standardised key facts document must be provided to the committee within twelve months.**

Disclosure requirements

5.70 Competition would be stimulated in the banking and non-banking sectors if better disclosure requirements existed at the point of purchase, to allow consumers to understand the full costs of the agreement that they are entering into. Fujitsu Consulting noted that:

53 Mr M North, Fujitsu Consulting, *Transcript*, 15 August 2008, p. 26.

> …at the moment the conditional fees and some of the other ancillary costs are not clearly disclosed, so it is really hard for a consumer to compare deal A to deal B and deal C. …we should be considering a more standardised approach to comparison rates. It should be more holistic. It should have all of the categories, all the costs and all of the interest flows at the rate today.[54]

5.71 CHOICE similarly notes that the industry relies heavily on disclosure to drive competition, but notes that if disclosure is going to work well 'then standardisation, in particular the naming of fees, …would be quite useful.' [55]

5.72 CHOICE also highlighted that financial institutions use different terms to describe one fee, as is the case with an early exit fee, and noted that steps taken in the UK to standardise financial terms stating:

> The approach taken in the UK for example has been to standardise the fee nomenclature. So all mortgage early exit fees are known as mortgage early exit fees. It does bring some transparency. This is something that ASIC has looked at in reviewing the mortgage entry and exit fees. …it only enhances disclosure and the capacity for consumers to compare products.[56]

5.73 Abacus, the peak industry association for Australian mutual building societies and credit unions, supports improving upfront disclosure to product information in clear and understandable terms for consumers but notes 'that is certainly not the situation we have at the moment with loan documentation'. Abacus told the committee that: [57]

> …at the moment in the documentation attached to home loans you would need to be a fairly dedicated consumer and reader of fine print to be able to track down exactly what fees you are paying in the first instance, and in the second instance how they are going to impact you if you wanted to terminate the loan early in the term. [58]

5.74 While disclosure requirements should not become so complex as to have too big an impact on the system, Abacus noted:

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54 Mr M North, Fujitsu Consulting, *Transcript*, 15 August 2008, p. 26.

55 Ms E Freeman, CHOICE, *Transcript*, 21 August 2008, p. 79.

56 Ms E Freeman, CHOICE, *Transcript*, 21 August 2008, p. 79.

57 Ms L Petschler, Abacus Australian Mutuals, *Transcript*, 21 August 2008, p. 7.

58 Ms L Petschler, Abacus Australian Mutuals, *Transcript*, 21 August 2008, p. 7.

> …we think that having a clear and upfront comparable outline of what fees you would incur in a number of set standard circumstances and bringing that forward in terms of disclosure for consumers would be a very beneficial outcome.[59]

5.75 According to the Treasury, the federal government is aware of the need for better disclosure and it is currently seeking to improve product disclosure requirements to make it easier for consumers to make informed financial decisions and compare products. The Treasury, in conjunction with the Department of Finance and Deregulation and ASIC, are working to 'develop short, concise and readable product disclosure documents that are effective for consumer decision making and for business in managing cost and legal requirements.'[60]

5.76 The Commonwealth Bank cautioned that more disclosure is not necessarily better, citing the Financial Services Reform Act (FSRA), the bank stated:

> …it has not helped with some government legislation like FSRA, which was overly weighty and it created the opposite effect of what it was trying to do. It created more disclosure, which meant more confusion. I think less is more is often quite a good principle when you go into legal documents and explanation of customer rights.[61]

5.77 Furthermore, it is the Commonwealth Bank's view that if competition is to be strong people must be allowed to be competitive and to do different things and be innovative:

> …if it becomes overly prescriptive you lose competition in the market because people cannot try and do different things or are constrained.[62]

59 Ms L Petschler, Abacus Australian Mutuals, *Transcript*, 21 August 2008, p. 7.

60 Treasury, *Submission no. 32,* p. 11.

61 Mr J Sheffield, Commonwealth Bank of Australia, *Transcript*, 25 September 2008, p. 24.

62 Mr J Sheffield, Commonwealth Bank of Australia, *Transcript*, 25 September 2008, p. 25.

Conclusions

5.78 The committee is of the opinion that the work of the tripartite Financial Services Working Group, under Treasury's guidance, is timely and will produce better disclosure requirements for banking and non-banking products.

5.79 The committee commends the work being done by the Financial Services Working Group to improve disclosure at the point of purchase. The committee supports and encourages the continuation of this work.

External dispute resolution

5.80 CHOICE told the committee that a key reform which is needed to improve competition in the banking and non-banking sectors is mandatory membership of external dispute resolution schemes for all financial services providers.[63] CHOICE stated that:

> Since their creation 15 or so years ago external dispute resolution (EDR) bodies have provided access to low cost and effective dispute resolution for customers of Authorised Deposit-taking Institutions (ADIs) and other scheme members. Developments in the Banking Code of Practice and practices of ASIC approved external dispute resolution schemes have also cemented better standards for dispute resolution between members and their customers.[64]

5.81 Currently, with the exception of ADIs, there is no legal obligation for other providers of credit or financial advice associated with credit, to belong to an external dispute resolution scheme, although some voluntarily belong to such schemes.[65]

63 CHOICE, *Submission no. 23,* p. 2.

64 CHOICE, *Submission no. 23,* p. 7.

65 CHOICE, *Submission no. 23,* p. 7.

5.82 In its recent report on Australia's Consumer Policy Framework, the Productivity Commission noted:

> Gaps in the regulation of credit providers and intermediaries providing advice on credit products mean that some consumers face excessive risks and have no guaranteed access to alternative dispute resolution.[66]

5.83 The Productivity Commission went on to note that:

> Amongst other things, the new national credit regime should include a national licensing system for finance brokers, and a licensing or registration system for credit providers that would give consumers guaranteed access to an approved dispute resolution service. [67]

5.84 External dispute resolution schemes were developed because of the almost insurmountable barriers in taking small and medium value consumer finance disputes to ordinary courts. CHOICE notes that currently there are four ASIC approved external dispute resolution schemes which deal with complaints about financial institutions and consumer credit. Where a credit provider is a member of one of these schemes consumers have access to an effective dispute resolution in relation to most disputes. The existing schemes are:

- the Financial Ombudsman Service (FOS);
- the Credit Union Dispute Resolution Centre (CUDRC);
- the Credit Ombudsman Service (COSL); and,
- the Financial Co-operative Dispute Resolution Scheme (FCDRS). [68]

5.85 In its submission CHOICE argued that all providers of consumer credit and advice related to consumer credit should be members of an ASIC approved external dispute resolution scheme. [69] Challenger Financial Services Group also supports the need to 'give people access to an external dispute resolution system'[70].

66 Productivity Commission, *Review of Australia's Consumer Policy Framework, Inquiry Report, Volume 1 – Summary, No. 45,* 30 April 2008, p. 59.

67 Productivity Commission, *Review of Australia's Consumer Policy Framework, Inquiry Report, Volume 1 – Summary, No. 45,* 30 April 2008, p. 66.

68 CHOICE, *Submission no. 23,* p. 7.

69 CHOICE, *Submission no. 23,* p. 8.

70 Mr D Cox, Challenger Financial Services Group, *Transcript*, 15 August 2008, p. 90.

5.86 The committee received many submissions from mortgage brokers, many of which stated that:

> An effective and efficient regulatory regime should require brokers to be a member of an external dispute resolution scheme to give borrowers access to an inexpensive and efficient mechanism for resolving complaints.[71]

5.87 An external dispute resolution body to which all licensed lenders must belong will soon be in existence as part of the government's recently flagged reform of the financial services regulatory regime. Reform will include the development of a single national system which will regulate consumer credit in order to establish a 'consistent and robust consumer credit regulation framework.'[72] The new framework will include a comprehensive national licensing regime to be administered by ASIC that will cover all credit providers, brokers and advisers.

5.88 Safeguards will be built into the new scheme, including the provision that all borrowers will be able to appeal to an external dispute resolution body to which all licensed lenders must belong. In this respect, Senator Sherry recently stated:

> The Corporations Act will be extended to cover margin lending products and trustee corporations. Organisations which extend margin loans will have to provide product disclosure statements similar to those provided for the First Home Saver Accounts.

5.89 The first phase of the new regime, including the provision for an external dispute resolution body for all licensed lenders, will be in place in commonwealth, state and territory legislation by the end of June 2009.

Conclusions

5.90 The committee notes that there is currently no legal obligation for providers of credit or financial advice associated with credit, other than ADIs, to belong to an external dispute resolution scheme, although some non-ADIs voluntarily belong to such schemes.

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71 See, for example, All Home Loans (Queensland) Pty Ltd., *Submission no. 46.* p. 2.

72 Senator the Hon N Sherry, Opening address to Evaluating Financial Services Regulation Summit, Sydney, 30 October 2008, as cited at: http://minscl.treasurer.gov.au/DisplayDocs.aspx?doc=speeches/2008/035.htm&pageID=005&min=njs&Year=&DocType=1

5.91 In view of the concerns expressed by CHOICE and other stakeholders, the committee welcomes and supports the creation, as part of government reforms of the financial services regulatory regime, of an external dispute resolution body to which all licensed lenders must belong, to be introduced by mid-2009.

Recommendation 12

5.92 **The committee recommends that, as part of its adoption of responsibility for the regulation of credit, the government make it compulsory for all credit providers to be a member of an external dispute resolution scheme approved by the Australian Securities and Investments Commission, as is currently the case for deposit-taking institutions.**

Craig Thomson MP
Chair
13 November 2008

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Appendix A – Submissions

No.	Provided by
1	CITE Centre for ideas and the economy
2	Professor Joshua S Gans
3	Mr Peter Mair
4	Mortgage and Finance Association of Australia
5	Collins Securities Pty Ltd
6	Better Mortgage Management Pty Ltd
7	Banking and Financial Services Ombudsman Ltd, Author
8	Aussie Home Loans
9	Fujitsu Consulting
10	The Rock Building Society Limited
11	Veda Advantage
12	Reserve Bank of Australia
13	GE Money
14	PMI Mortgage Insurance Ltd
15	LIXI Limited
16	Mortgage Choice Limited
17	Community CPS Australia Ltd

18	Australian Finance Conference
19	Credit Ombudsman Service Limited
19.1	Credit Ombudsman Service Limited (Supplementary)
20	Resi Mortgage Corporation Pty Limited
21	Brotherhood of St Laurence
22	Mates Rates Mortgages
23	CHOICE
24	Council of Mortgage Lenders
25	Wesley Mission
26	Australian Bankers' Association Inc.
27	Commonwealth Bank of Australia
28	ANZ
29	Bank of Western Australia Ltd
30	Australian Securitisation Forum
31	National Australia Bank
31.1	National Australia Bank (Supplementary)
32	Australian Treasury
33	Consumer Credit Legal Centre NSW Inc; Care Inc Financial Counselling Service and the Consumer Law Centre of the ACT
34	Australian Prudential Regulation Authority
35	Consumer Action Law Centre
36	Mr Kevin Vierboom
37	Genworth Financial
38	Department of Consumer and Employment Protection Western Australia
39	Finance Sector Union
40	Challenger Financial Services Group
41	Mr Geoffrey R Hodgkinson
42	Abacus - Australian Mutuals

42.1	Abacus - Australian Mutuals (Supplementary)
43	Australian Payments Clearing Association
44	Reserve Bank of Australia
45	Ms Maria Rigoni
46	All Home Loans (Queensland) Pty Ltd
47	Mortgage Ezy
48	Finance Brokers of Tasmania Pty Ltd
49	Get Financed (NSW) Pty Limited
50	Private Lender
51	Barker-Smith Finance
52	CBC Home Loans
53	The Money Tree
54	Wheatley Financial Services Pty Ltd
55	Liberty Financial Services
56	Refund Home Loans
57	Beltina Pty Limited
58	Choice Home Loans
	(additional 346 form letters are listed below)
59	ING Direct
60	Reid Consultants

Additional form letters

Organisation	From
	Bruce Conn
	Jonathan Joyce
	R E Russell
MortgageBroker.com.au	Stephen Bastick
ADA Financial Services	Deb Hammersley
Advanced Mortgage & Legal Group	Erik Laane
A-Lend	Teo Torrelli, Director
Auscredits	Donna Wood
Auscredits	Victor Gonzalez
Auscredits	Kylie Schulke
Auscredits	Stephen Davis
Auscredits	Jim Easton
Auscredits	Andrew Keir
Aussie Mortgage Masters	Geoff Burden
Colonial State Capital	John Angelou, Business Manager
DPS Financial Services Pty Ltd	David Soorkia
EIP Mortgage Solutions Pty Ltd	Gary Dodd
Elders Home Loans	Nicole Cruickshank
Finance Brokers of Tasmania Pty Ltd	David Haas
Financial Zone Pty Ltd	Peter Ioannidis
Green Light Home Loans	Bevin Weier
Green Light Home Loans	Ken Pitt
Habitat Finance & Insurance	Rory Cowman, Director
Home2Home Loans Pty Ltd	Matt Cook

Homeloans 1st	Xenia Pericich
Horizon Mortgage Planners Pty Ltd	Pauline Murray, Director
Infinity Partners Finance	Sean Soole, Director/CEO
Integrity Loans	Robert Knight, Manager
Intelligent Finance	Philip Ioannou
Intelligent Finance	Kevin Croom
Intelligent Finance	Justin Doobov
Lonestar Finance	Indira Panicker
M&J Financial Services	Mark Jenson, Director
Maverick Financial Services	Paul Brotherson, Director
Maverick Financial Services	Nick Allman, Senior Finance Consultant
Meares Funding	Grant Marshall, Senior Lending Manager
Meares Funding	Adam Gubbay, Project Finance Executive
Medina Financial & Legal Services	Saad Hussein, National Sales Manager
Mint Financial Services Pty Limited	Graham Gribble, Director
Moneywise Group	Dario Basili, Manager Loans & Leasing
Mortgage Simplicity	Robert Seton, Managing Director
MSBN Loans	Naresh Mehrok, Mortgage Broker
Nest Egg Solutions	Terry Thane
O'Keeffe Financial Solutions	Paddy O'Keeffe, Director
Premium Mortgage Group	Aydn O'Neill
Prime Partners Lending Pty Ltd	Patrick Kazzi
Pro Mortgage	Wayne Pattison, Director

ProMortgage	Keith McLaren
ProSolution Private Clients	Stuart Wemyss, Director
Quantum Loans	Terry Brown, Principal
Real Financial Solutions	Neville Herse, Director
Rightgroup.biz	Victor Kumar
Riverina Finance	Nicole Cruickshank
Sage Lending Solutions	Peter Tersteeg
Salisbury Partners	R A Roumanus, Director
Smart Lending Solutions	David Alderdice, Director
Top End Homeloans	Andrew Harley
WhyGroup	Petros Arvanitis, Managing Director
You Select Home Loans	Allan W Pearson, Director
Summit 21 Home Loans	Karen Nahm, Director
Titanium Planners	Andrew Blanchette
	Peter P Troiano
	Peter Dunn
	Aussi Mchugh
Action Mortgage Finance	Doug Barlow, Director
Action Mortgage Finance	Don Burman, Director
Aeoliana Finance	Damien Zanin, Director
All Coast Home loans & Finance	Greg Crellin
All Facets financial Services	Leigh P Salter
Ambrosia Mortgage Services	Sylvie Lo Monaco
Aus Asia Finance	Patricia Goh, Principal
Auscredits	Lynne Sturgess
Auscredits	Sylvia Turpin

Auscredits	Kathy Curry
Aussie Mortgage Masters	Lynne Cox, Director
Australian Lending Centre	Chris Riotto
Australian Lending Centre	Lili Amphone
Australian Lending Centre	Verushka Naidoo
Australian Lending Centre	Karolina Rongo
Australian Mortgage Alliance	Spenser Fong, Principal
BC Home Loans	Bradley James Collett, Director
Big Picture Financial Solutions	Karen Delvaux
Big Picture Financial Solutions	Richard Flint
Big Picture Financial Solutions	Simon Tanner
Capital Lending Group	John Boudoukos
Carlsan Financial Services	Carl A Loughman, Personal Mortgage Adviser
Cascade Home Loans Pty Ltd	George Gyeorffy
Central Credits Pty Ltd	Peter MacSween, Director
Channel Direct Home Loans	Robyn Roberts
Channel Direct Home Loans	Fred Roberts
Chocolate Money	Harry Pontikis, Director
Richard Tegoni, Director	
Choice Home Loans	Michael Eyles, Principal
Choice Home Loans	Jeff Geering, Principal
Choice Home Loans	Debbie Love
Choice Home Loans	Jeff Gerrans, Principal
Commercial Brokers Australia	Gary Davis, Director and Mark Grady, Partner
Cosimfree Home Loans	Andrew Edmunds

Crawford Mortgage Services	John Maynard, Director
Eastcoast Finance Options Pty Ltd	David Smith, Finance Strategist
Equity Express Pty Ltd	Tim Salway
Expert Lending	Selina Yong
Expert Lending	Paula McSporran
Expert Lending	Andrew Hill
Expert Lending	Steve Moore
Finance Brokers of Tasmania Pty Ltd	Ken Walton
Finance Solutions 24/7	Chris Crawley, CEO
Finance Solutions 24/7	Craig Adams
Finance Solutions 24/7	Tanya Shaw
First 4 Finance	Gary Strickland, Director
Fort Knox Home Loans	Robert Knox, Mortgage Planner
Fox Morris Financial Services	Adam Johnstone
Freedom Home Loans	Roy Shippen
Global Capital Finance Solutions	Neville Halil
Graham Quast Home Loans	Graham Quast, Manager
Group Finance & Associates Pty Ltd	P J Boyle, Director
Hawkins Financiers	Rick Hawkins
Ikon Finance Pty Ltd	Ling Ying Wang
Investor Loans Network	Andrew Blackburn
Jess Bryant Financial Services Pty Ltd	Jeff Bryant
John Rose & Associates WA	John Rose
Joseph Previti, Mortgage Manager	Joseph Previti
Joslan Securities Pty Limited	Geoff Neilson, Managing Director
KamBiz Mortgage Services	Kamran Sedghi

Kennedy Financial Solutions Pty Ltd	Susan Kennedy
Keyfern Finance	J G Gray, Director
Macquarie Commercial Finance	Lauren Smallsman, Personal Assistant
Macquarie Commercial Finance	Tim Lowe, Director
Macquarie Commercial Finance	Andrew de Saxe, Finance Consultant
Marble Finance	Joel Schonberg, Director
Master Lending Services	Neil McCahon
Matera Harper Kahl	Craig Harper, Director
Matera Harper Kahl	Carl Matera, Director
Matera Harper Kahl	Simon Kahl
Midas Mortgages	Charlton Kerr
Mortgage Fair	Barry Howlett
Mortgage Link	Chris Lloyd, Director
Mosaic Home Loans	L D McCormack
Nevlyn Financial Services	Nev Kross
NSW Mortgage Corp Pty Ltd	Amelia Soares
One for Home Loans	Grahame Bishop
Personal Mortgage Managers	Anthony Damen
Personalised Financial Services Pty Ltd	Keith Alexander
Peter Gomm & Associates Pty Ltd	Peter Gomm
Professional Financial Services WA	Frances Letizia & Neil Pendlebury, Directors
Real People Finance	Brett Abikhair, Director
Red Finance Pty Ltd	Darryn Gledhill
Red Finance Pty Ltd	Peter Smith
RLA Finance Australia	Ralph M Lawson

Sentrik Finance	G J Harris
Sentrik Finance	K B Feltham
Serenity Finance Services	C W Gates, Finance Consultant
SFE Loans	Sarah Eifermann
Smart Financial Pty Ltd	Dale Bannerman, Director/Lending Advisor
Southern Cross Loan Centre	Travis Garmony
Specialised Mortgage Solutions	Barry Swain, Mortgage Adviser
Stateplan Business Finance Brokers	Peter Smith
The Australian Mortgage Specialists	Judy Kohler
The Australian Mortgage Specialists	Trish Lalicz
The Australian Mortgage Specialists	Jessica Kohler
The Loans Analyst	Theo Angelopoulos, Manager
Veritas Lending	Georgina Anderson, Principal
Wealth-Café Home Loans	Peter Colvin, Director
Westap Finance	Tony Pemberton
Westate Finance	Kevin Pausin, director
Zobel	Brad Smart
A Milner Financial Services	Adrian D Milner
Able Finance Services	Sam Crowley
Absolute Financial Services	Mark Cook
Almarex Financial Solutions Pty Ltd	Alexander Marchinovskiy, Managing Director
CGB Finance Consultants Pty Ltd	Colin Brennan
Choice Home Loans	Narelle Beak
Choice Home Loans	Geoff Sinfield
Deakins Home Loan Supermarket	David Deakin

Expert Lending	Jason Knauer
Finpro Finance & Property Solutions	David Painter, Director
Harvest Financial Services	Alan Plumridge, Director
Home Finance Centres of Australia	Alan Watkinson, Business Development Manager
Invent Pty Ltd	Tim Murray, Director
L J Hooker Financial Services	Gerard Credlin
Mason Management Financial Services	Greg Mason, Principal
Pegasus Finance	Peter Ramsay, Finance Director
Prescott Securities	Paul Frisby, Manager
Raine & Horne Financial Services	Shirley Philp
Refund Home Loans	Steven Whitfield, Principal
Reward Home & Commercial Loans	Lisa Berg, Director
Savvy Finance Group	Noel Ryan
Source Financial Services	Gexuan Wu, Senior Mortgage Broker
The Australian Mortgage Specialists	Maggie Shortus
The Australian Mortgage Specialists	Doug Bannister
The Australian Mortgage Specialists	Peter Green
The Australian Mortgage Specialists	Jan Lowe
	Peter Schrader
Able Finance Services	Shane Crowley
Able Finance Services	Glenn Humphrey
Able Finance Services	Michael Best
Able Finance Services	Laurie Williams
Able Finance Services	Martin Mills
Able Finance Services	Derek Lee
Able Finance Services	Steve Banks

All Finanz Solutions	Scott Abraham, Director
Business and Wealth Solutions	Brian McClelland
Custom Mortgage	Heather Pinder, Director
Encompass Financial Services	Steve Skeen
Encompass Financial Services	Lloyd Hughes
Financial Needs	John Grabowski
Fuel Finance	Craig Morgan, Director
Inlet Finance	Mark Barrett
Investors Choice Mortgages	Jane Slack-Smith, Director
Logical Choice Finance	L J J Cantwell
Lord Finance	Mark Lord
Lynx Network Asset Strategies	Lorrischka Fischer, Principal
Macquarie Commercial Finance	Bruce McIntyre, Finance Consultant
Mortgage & Finance Professionals	Ben Baker
National Farm Finance of Australasia	Raymond Hastie, Senior Mortgage Consultant
Ocean Home Loans	Brad Kirwan, Principal
Rob Walmsley Financial Services	Robert Walmsley
Universal Finance Pty Ltd	Adam Dobek
Universal Finance Pty Ltd	A Marquez
Choice Home Loans	Jamie Lopez, Principal
Choice Home Loans	Robert Wheeler, Principal
Macquarie Commercial Finance	Adam Rugg, Finance Broker
Macquarie Commercial Finance	Graeme Brown, Finance Consultant
Macquarie Commercial Finance	Tracey Hosking, Personal Assistant
Macquarie Commercial Finance	John Encina, Finance Consultant
Absolute Lending Solutions	Ritchie McGuinness, Director

Spectrum Tailored Mortgages Pty Ltd	Reid Swift
JayJayem Consulting Services	Jay Menon
Oshawa Financial Services	Richard Luke
ADA Financial Services	Roxy Garro
XS Finance	Peter Maroudas, Mortgage Broker
Assess Financial Services Pty Ltd	George Kostanski
Property Finance Online	Michelle Hall, Finance Consultant
Franck Finance Pty Ltd	Ruth Franck
Education Mortgage and Finance	Graham Bridgewater
Choice Home Loans	Daniel Radley, Mortgage Consultant
LJ Hooker	Michael Lodding, Finance Broker
Loanforce Financial Solutions	Michael Tranter, Finance Broker
Span Finance	Jeff Colley, Mortgage Introducer
Coastline Mortgage Services	Jerry Gibb
West Coast Leasing and Finance	Tibor Vagra
West Coast Leasing and Finance	Hans Beyer, Finance Broker
West Coast Leasing and Finance	Denis Jarovljevic
West Coast Leasing and Finance	Alan McGowan
West Coast Leasing and Finance	Kee Shiang Poon
West Coast Leasing and Finance	Amanda Cook
West Coast Leasing and Finance	Bruno Primus
West Coast Leasing and Finance	Clinton Pearce
LJ Hooker Financial Services	Angelo Salis
Choice Home Loans	Karen Maddison, Mortgage Consultant
Loans 4 Sure	Barry Bridgeman, Finance Broker
Infina	Sean Blattman

Infina	Lloyd Thomas
Infina	Samuel Khalil
Hill Ross	John O'Ryan, Manager
Merlot Finance Australia Pty Limited	Michael Allen Hughes
BG Homeloans Pty Ltd	Grant Hawkswell
Ocean View Home Loans	Ivy Dos Santos
Winning Edge Financial Services	Matthew John McLaglen
Winning Edge Financial Services	Chris Worthley, Proprietor
Moody Kiddell & Partners	Robert Brownlow
Econ Finance Pty Ltd	Paul Shahinian
Select Mortgage Services	Peter Erzay, Finance Manager
Vertex Financial Solutions	Michael Doyle, Director
Forrest Financial	Tony Forrest
Choice Home Loans	Sharon Coles, Mortgage Consultant
Loans 4 Sure	Julie Bridgeman, Finance Broker
Your Finance Group Pty Ltd	John Annear, Mortgage Broker
WHK Mortgage First	Margaret Lucas, Finance Professional
Refund Home Loans	Rodney Eastment, Territory Manager
Acclaim Mortgage & Finance	Andre Burress, Finance Specialist
Choice Home Loans	Peter Warwick
Damara Finance Services	Terry Wilson, Director
Queensland Financial Services Pty Ltd	Terry Hill, Director
FinMart Finance Brokers	Bill Keenes, Principal
Equal Partners	Casey Hart
Colonial State Capital	Susie Angelou
ESC Finance Solutions	Peter D'Arcy

Choice Rates Pty Ltd	Anthony John Blanch
LJ Hooker Financial Services	Tina Broadhurst
Legal & General Properties	Kelvin Gough, CEO and MD
Choice Home Loans	Mark Ballard
Refund Home Loans	Valorie Guldbaek, Territory Manager
Mortgage Foundations	Ian McDonald, Director
Westminster Lending Corporation	John Kiely
Choice Home Loans	Rhonda Kendall
Loan Scan	Damien Arts, Principal
Loan Scan	Paul Hampel, Loan Consultant
Elders Home Loans	Ian Wachtel, Regional Development Manager
BFS Finance	Col Binding
Refund Home Loans	Flemming Guldbaek, Territory Manager
Driver Business Solutions Pty Ltd	Nick Driver
Southside Mortgages	Wendy Beverakis, Director
Velocity Home Loans	Scott Langford, Director
	Suzanne Sykes
Option One Financial Partners	Mark Hossen, Director
Holdfast Finance Pty Ltd	Geoff Carter
Loans 4 Sure	Todd Bridgeman, Director
Queensland Financial Services Pty Ltd	Trevor Creeley, Director
Midas Group	Jaclyn Merlino, Director
Loanstream Finance	Geoff Kitson
One Site Financial Solution	Liz Zaki, Loans Advisor
Finance Corp	Julie Ivey

John Baggott & Associates Pty Ltd	Andrew Townsend
Pro Mortgage	Gavin Moroney
Westate Finance	Mark Rigby
WHK Mortgage First	Michael Bratby
Finance Tactics Mortgage Brokers	Tina Pupello
Best Home Loans & Mortgage Services	Jemmy Best
Dencorp Financial Solutions	Steven Denver
Ernst & Jones Finance	Brad Jones
	Russ Jewell
Need a Mortgage Pty Ltd	Glen Miller
Boutique Finance	Shane Will
Boutique Finance	Cheryl Quabba
Gray Mortgage Originators	Simon Gray
Gray Mortgage Originators	Nathan Xenophontos
ADA Financial Services	Jamie Hammersley
Your Finance Group Pty Ltd	Raymond Webb
Queensland Financial Services Pty Ltd	Lisa Venaglia
Wells Partners	Frank Schiraldi
Patto's Finance on the Go Pty Ltd	Kylee Pattison
Larry Walker Home Loans	Larry Walker
Elite Banking Related Solutions	Ben Nicholls
Aussie Mortgage Masters	Aron Cox
Choice Home Loans	Maria Siracusa
Choice Home Loans	Peita Davies
Choice Home Loans	Katrina Couchman
Total Home Loan Options	Sharene Dearlove

Good Ideas Man	Peter Mullane
Melbourne Broker Alliance Pty Ltd	Michael W E Hosking
Vasse Finance	Sophie Dwyer
All Finance Pty Ltd	John Swanson
Precise Finance Solutions Pty Ltd	David Morgan
Refund Home Loans	Annette Law
Ryan Mortgage & Finance Pty Ltd	Chris Ryan
Choice Home Loans	Sharyn Perrott
	Adrian McMahon
Woodview Home Loans and Finance	Dean Brown
Choice Home Loans	Roland Serventy
First Choice Mortgage Solutions	Steven Andrews
North West Finance Pty Ltd	Brian J Smith
Home Star Finance	Bridget Allan
Premier Finance & associates Pty Ltd	Cameron Dunlop
Tailored Lending Concepts	Stephen Rasmussen
	K Heading
Mrs Mortgage	Jennifer M Schelbert
Centrepoint Finance QA Pty Ltd	Murray Jackson

B

Appendix B – Exhibits

No.	Description
1	Presented by the Australian Securitisation Forum *Annexes 1 – 9: ASF Financial Services and Credit Reform Green Paper; Repo summary table; BIS the role of Govt. supported Fin Agencies; BIS the role of Govt. supported Fin Agencies; Creating a Govt sponsored enterprise for Europe; UK Treasury Whitepaper; BIS Outline of the Covered Bond Market; Covered Bonds Basics – PIMCO; Agency model discussion paper; covered bonds submission* (Related to Submission no. 30)
2	Presented by the National Australia Bank *NAB Customer Promise Brochure* (Related to Submission no. 31)
3	Presented by Fujitsu Consulting UK Mortgage Information (Related to Submission no. 9)

4 Presented by Aussie Home Loans

The John Symond Paper – Addressing the Housing Affordability Crisis, 21 August 2007

(Related to Submission no. 8)

5 Presented by Mr Kevin Vierboom

Additional notes to the House of Representatives Standing Committee on Economics

(Related to Submission no. 36)

6 Presented by Mates Rates Mortgages

Verbal Evidence, Inquiry into competition in the banking and non banking sectors

(Related to Submission no. 22)

7 Presented by Challenger Financial Services Group

Opening statement

(Related to Submission no. 40)

C

Appendix C – Hearings and witnesses

Friday, 8 August 2008 – Melbourne

The Rock Building Society Limited

Mr Derek Lightfoot, Managing Director

Mr John Maxwell, Chairman

Consumer Action Law Centre

Ms Carolyn Bond, Co-Chief Executive Officer

Ms Nicole Rich, Director, Policy and Campaigns

Collins Securities Pty Ltd

Mr Robert James Emmett, Managing Director

ANZ

Mr Michael Campbell Rowland, Managing Director, Mortgages

Mr Paul Braddick, Head of Property and Financial System Research, ANZ Economics and Markets Research

Ms Jane Erin Nash, Head, Government and Regulatory Affairs

Bank of Western Australia Ltd

Mr Ian Corfield, Chief Executive, BankWest Retail

Ms Lisa O'Connor, Manager, Regulatory Risk and Legislative Change

Brotherhood of St Laurence

Ms Nicola Ballenden, General Manager, Communications and Development

Ms Genevieve Sheehan, Microfinance Manager

Thursday, 14 August 2008 – Sydney

Reserve Bank of Australia

Mr Ric Battellino, Deputy Governor

Dr Philip William Lowe, Assistant Governor, Financial System

JP Morgan

Mr Brian Johnston, Bank Analyst

The Treasury

Ms Susan Bultitude, Acting Executive Level 2, Financial System Division

Ms Veronique Anne Ingram, Acting Executive Director, Markets Group

Mr Jim Murphy, Executive Director, Markets Group

Ms Kerstin Wijeyewardene, Acting General Manager, Financial System Division

Mortgage and Finance Association of Australia

Mr Phil Naylor, Chief Executive Officer

Aussie Home Loans

Mr John Symond, Founder and Chief Executive Officer

Australian Prudential Regulation Authority

Mr Wayne Byres, Executive General Manager, Diversified Institutions Division

Mrs Heidi Richards, General Manager, Industry Technical Services

Council of Mortgage Lenders

Mr Peter James, President

Mrs Susan Redden Makatoa, Adviser

Private Capacity

Mr Kevin William Vierboom

Friday, 15 August 2008

Veda Advantage

Mr Christopher Dolan Gration, Manager, External Relations

Mr Matthew Adam Strassberg, Senior Adviser, Government Relations

Resi Mortgage Corporation

Miss Lisa Maree Montgomery, Head of Marketing and Consumer Advocacy

Fujitsu Consulting

Mr Martin North, Managing Consulting Director

Australian Securitisation Forum

Mr Greg Medcraft, Chief Executive Officer and Executive Director

Mr Phillip Vernon, Chairman

Genworth Financial

Mr Peter Hall, Country Executive

Mr Craig Mackenzie, General Counsel

Australian Finance Conference

Mr John Bills, Associate Director

Mr David Thorpe, Associate Director

Mates Rates Mortgages

Mr Michael Tsoa-Lee, Co-founder

Challenger Financial Services Group

Mr Brian Roland Benari, Chief Executive

Mr David Alexander Cox, Head of Government Relations

Mr Dominic John Stevens, Deputy Managing Director

Thursday, 21 August 2008

Abacus Australian Mutuals

Ms Louise Margaret Petschler, Chief Executive Officer

Mr Mark Degotardi, Head of Public Affairs

Private Capacity

Mr Peter Mair

Australian Payments Clearing Association

Mr Christopher John Hamilton, Chief Executive Officer

Dr Brad John Pragnell, Head of Industry Policy

Credit Ombudsman Service Ltd

Mr Raj Venga, Credit Ombudsman

Wesley Mission

Reverend Dr Keith Vincent Garner, Superintendent/Chief Executive Officer

Mr Graeme Eric Cole, Public Affairs Manager

Centre for Ideas and the Economy

Professor Joshua Gans, Private Capacity

Mr Christopher Ronald Edward Joye, Managing Director, Rismark International

CHOICE

Mr Gordon Renouf, Director, Policy and Campaigns

Ms Elissa Freeman, Senior Policy Officer

Westpac Banking Corporation

Mr William David Malcolm, General Manager, Risk, Product and Operations

Mr Kelvin Lawrence, General Manager, General Manager, Mortgages, Product and Operations

Friday, 19 September 2008

National Australia Bank

Mr Steven Shaw, Group Manager, Mortgages and Consumer Insurance

Mr Steven Munchenberg, Group Manager, Government Affairs and Public Policy

Ms sarah Ward, Manager, Government and Regulatory Affairs

Australian Competition and Consumer Commission

Mr Mark Pearson, Executive General Manager, Enforcement and Compliance Division

Mr Justin Thompson, Acting General Manager, Mergers and Asset Sales

Ms Danielle Wood, Director, Mergers and Asset Sales Branch

Ms Morelle Bull, Assistant Director, Mergers and Asset Sales Branch

Australian Office of Financial Management

Mr Neil Hyden, Chief Executive Officer

Mr Michael Bath, Director, Financial Risk

Finance Sector Union

Mr Leon Carter, National Secretary

Mr James Bennett, Senior Policy and Research Officer

Members Equity Bank

Mr Anthony Wamsteker, Chief Executive Officer

Australian Securities and Investments Commission

Mr Jeremy Cooper, Deputy Chairman

Mr Greg Kirk, Senior Executive Leader, Deposit Takers, Credit and Insurance Providers

Thursday, 25 September 2008

Australian Bankers' Association

Mr James Sheffield, General Manager, Mortgage Wealth

Commonwealth Bank of Australia

Mr David Bell, Chief Executive Officer

Mr Nicholas Hossack, Director, Prudential, Payments & Competition Policy

Thursday, 16 October 2008

ING Direct

Mrs Lisa Claes, Executive Director, Direct Business

Mr Brett Morgan, Executive Director Intermediary Mortgages