SUBMISSION 6

Inquiry into Competition in the Banking and Non-Banking sectors

10th July 2008

Terms of Reference:

- Recent developments in relation to products, providers and distribution channels
- The current state of the retail banking and non-banking industries
- The likely drivers of future change and innovation in the retail banking and non-banking sectors including the continuing impact of technological developments

Recent developments in relation to products, providers and distribution channels

The ‘credit crunch’ which commenced in August 2007 and continues today has had a major effect on non-bank lending, in particular the type of lending which falls outside of general bank lending criteria.

This doesn’t necessarily mean credit impaired or ‘sub-prime’ borrowers, but also those borrowers looking to get into the market with a smaller deposit and those with employment structures that make it difficult to prove their income in the traditional manner accepted by the banks.

The result is that many borrowers who would previously have been eligible for a non-bank loan are now faced with not being able to borrow at all, or are forced into more expensive private loans through solicitors and other firms.

For many specialised providers of funds, especially those which rely solely on the money markets, the lack of liquidity has forced them to either reduce the amount of lending they are doing, or in quite a few cases cease operations entirely. As a result many staff in the non-bank lending industry have been laid-off over the last six months or so.

In addition to hurting business in the ‘specialist’ or ‘non-conforming’ market, the difficulties have also affected the ‘mum and dad’ type borrowers as the cost of funds for non-bank lenders increases. Previously customers were able to come to non-banks for rates which were often below the rates provided by the banks. The increased cost of funds has made it much more difficult to compete with the banks due to their large deposit bases which make them more (but not completely) immune from the difficulties in the money markets.

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

Like credit unions and building societies, non-bank lenders are known for their more personalised service to customers. Banks on the other hand are often mentioned for all the wrong reasons when it comes to customer service.

The credit crunch, and the resulting media hype that unfairly advised customers they should switch from non-banks to banks, has resulted in a strong swing in loans being placed with banks as opposed to non-banks.

With customers moving back towards the banks they will generally receive a lower standard of service, and as competition weakens further between banks and non-banks, there will be even less incentive for banks to improve their service.

The likely drivers of future change and innovation in the retail banking and non-banking sectors including the continuing impact of technological developments

The opening up of money markets, if they return to their pre-August 2007 form, should result in returned competition between the banks and non-banks. Another alternative is the 'AussieMac' scheme, which the Senate Select Committee on Housing Affordability recommended be examined by the Treasury Department with a view to determine whether or not it would be beneficial for the Australian market.

The AussieMac scheme would be based on similar schemes overseas, such as the one operating in Canada. This would allow non-banks to continue writing new business at rates competitive with the banks. The increased competition would result in better rates and better service for customers, as well as a wider range of product types to suit more customers.

Conclusion

If the level of competition between banks and non-banks is allowed to continue sliding, customers will be the main losers with higher rates, less choice and a lower standard of customer service. A strong non-bank industry is vital to competition in the Australian mortgage market.

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