16 February 2004

First Home Ownership Inquiry
Productivity Commission
Locked Bag 2, Collins Street East
MELBOURNE VIC 8003

Per email: housing@pc.gov.au

Dear Sir/Madam,

Productivity Commission *'First Home Ownership'* Inquiry

Thank you for the opportunity to provide this response to the Productivity Commission's *First Home Ownership Inquiry* and in particular its December 2003 discussion draft. Credit Union Services Corporation (Australia) Limited (CUSCAL) believes that the *First Home Ownership Inquiry* provides a useful addition to the current debate about housing affordability. It is important that there is open and robust discussion about any changes to those factors believed to have an impact on housing affordability in Australia. This response is limited to only the status and appropriateness of the regulatory requirements applicable to the lending market and relevant to credit unions.

1. Features of the credit union sector

CUSCAL is the peak industry body and aggregated services provider for the majority of Australia's 179 credit unions, with 157 affiliated institutions. Credit unions play an important role in the financial sector, with more than 3.5 million members across Australia and total credit union assets at $28.1 billion (as at February 2004). Credit unions have a common set of values and ethics that govern their operations. These values and ethics are focused on delivering the best possible benefits for their members. Collectively, credit unions represent a significant share of the deposit-taking market, offering their members a mutual, community-based alternative to meeting their banking and financial services needs.

2. Regulatory issues

CUSCAL has two main concerns in relation to the regulation of the mortgage-lending sector, these are:

- the differences in the regulatory treatment of ADI and non-ADI lenders; and
- any proposed tightening of regulatory controls in response to the perception that the housing market is over-heated.

2.1 Regulatory treatment of ADI and non-ADI lenders

Credit unions, like banks and building societies, are authorised as deposit-taking institutions under the *Banking Act 1959* to conduct banking business subject to APRA supervision. In addition to other forms of regulation[1], credit unions are also subject to the *Uniform Consumer Credit Code*[2] (*UCCC*), which imposes specific obligations on all contracts for the supply of credit to individuals for personal, domestic or household purposes[3]. These various limbs of the regulatory framework ensure credit unions focus on borrowers' ability to service their loans and that those loans are backed by appropriate security[4]. Accordingly, CUSCAL believes that ADIs lending practices are sound and based on high and uniform standards and that credit unions are acting responsibly and prudently in the provision of loans to borrowers. This view is based on credit unions' compliance with their broad regulatory obligations and with regard to the nature and maturity of the Australian mortgage market and credit unions' extensive use of lenders mortgage insurance (LMI).

However, the housing lending market also consists of a range of non-ADI lenders such as mortgage originators, intermediaries and others. These participants are generally not subject to the same regulatory and supervisory control as ADIs. There have been a number of recent innovations in this market, for example, the use of LMI to secure low-deposit loans, low doc loans for borrowers who are unable to produce traditional income evidence to demonstrate loan serviceability, high loan-to-value ratio (LVR) loans (sometimes as high as 100 per cent), deposit bonds and non-conforming or sub-prime loans for borrowers who cannot meet equity or income lending criteria. These innovations have driven significant growth in the number of lenders and the availability of housing finance.

This is partly because these innovations have eased the constraints imposed by traditional lenders on borrowers' repayment obligations relative to their income and they have facilitated a reduction in deposit requirements. The result is that non-ADIs can operate in direct competition with ADI lenders, yet they are not necessarily subject to the same regulatory standards. For example, many lenders rely on securitisation to finance their lending, but unlike ADIs, mortgage originators do not need to comply with the prudential regime. Another example is where non-ADI lenders provide offset accounts in connection with their home loan products; even though these facilities usually have similar functionalities as deposit accounts, they are nevertheless regulated differently.

The doubling of non-bank lenders' market share in the 1990s, to 20 per cent of all new lending, exacerbates these concerns[5]. CUSCAL believes that the consequences of this regulatory divide could create uneven depositor protection and expose the financial system to systemic risk. Additionally, CUSCAL fears that this regulatory

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[1] ADIs are subject to regulation by ASIC under the *Corporations Act 2001*, which includes the extensive reforms of the FSR regime that commenced in March 2002[1]. Additionally, the RBA, the ACCC together with the State-based fair-trading offices provide further regulatory and consumer protection coverage.

[2] http://www.creditcode.gov.au/

[3] Relevantly, a key feature of the *UCCC* regime involves an obligation on lenders to establish a borrowers' capability to service a loan. A breach of this obligation can lead to severe criminal and civil penalties.

[4] Standard and Poor's, *'An investor guide to Australia's housing market and residential mortgage-backed securities'*, 26/01/03 at 19, located at http://www.standardandpoors.com.au.

[5] ABS, *'Value of housing loans advanced by institutions'*, cited in Standards and Poor's, *'An investor guide to Australia's housing market and residential mortgage-backed securities'*, 29/01/03 at 18, located at http://www.standardandpoors.com.au

divide potentially places ADIs at a competitive disadvantage to non-ADI lenders. Therefore, CUSCAL argues that, if mortgage originators or other non-ADIs wish to position their products to compete in the housing finance and associated lending markets, they should be subject to comparable regulatory regimes or supervisory controls that protect borrowers to at least the same standard as ADI lenders.

2.2 Housing affordability and possible regulatory reform

CUSCAL is pleased that the Productivity Commission[6] recognises that although easier access to finance has contributed to increased competition in the lending market and the strength of the housing market generally, the growth in access to finance is not on its own responsible for the housing bubble. Therefore, CUSCAL believes that the growth in the number of lenders and the variance in their lending practices should not be overstated. Instead, any proposed regulatory response to housing affordability should first identify critical risk areas and consider an appropriate range of regulatory and non-regulatory responses.

CUSCAL agrees that although the innovations described in 2.1 (above) may foster healthy competition and deliver cheaper and more accessible finance for borrowers, they may also contribute to concerns about lending practices, particularly the lending practices of less-regulated non-ADIs. Of overall concern is that sub-standard lending practices could lead to increased risks for borrowers, who become caught in totally unsuitable arrangements, and broader systemic risks for the lending sector[7]. In this context, CUSCAL is worried that any remedial regulatory measures could be unintentionally misdirected. That is, because ADIs are already sufficiently regulated, any tightening of ADI regulation may have very little practical effect other than adding to institutions' costs, while at the same time it may fail to address key risk areas in the lending market where regulatory coverage is thinnest.

Further, there is evidence emerging that the growth in the housing market is beginning to ease. For example, the number of home loan approvals fell for a third successive month in December 2003[8], the proportion of loans to first home buyers dropped to a record low of 13.1 per cent[9] and loans for new construction also eased[10]. Arguably, these figures are evidence that the rise in interest rates in 2003, in combination with the fallout over the closure of a prominent property seminar business[11] and the continuing cautionary messages from governments[12], regulators and commentators[13] have slowed housing market growth. Accordingly, CUSCAL believes that if the heat of the housing market is easing, then any proposed regulatory responses to the availability of finance should also be tempered.

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[6] Productivity Commission, *'First Home Ownership Inquiry'*, (2003)
[7] The recent soft-dollar commission/sponsorship controversy between Mortgage Choice and the CBA may be evidence of these types of concerns. See Needham K., *'Loan brokers forced to disclose kickbacks'*, Sydney Morning Herald, 21/01/04
[8] Parker J., *'Eyes on rates as home approvals slump'*, Australian Financial Review, 03/02/04 and Murphy C., *'Dwelling approvals fall again'*, Australian Financial Review, 04/02/04 at 5., Parker J., *'Home loans down again'*, Australian Financial Review, 13/02/2004.
[9] ABS figures cited in Pearlman J., *'Home lending drops amid rate speculation'*, Sydney Morning Herald, 20/01/04 at 5.
[10] Wade M., *'Housing market in doldrums'*, Sydney Morning Herald, 14/02/04 at 6.
[11] O'Loughlin T., *'Few curbs on spruikers'*, Australian Financial Review, 19/01/04 at 45.
[12] See interview of the Hon. Peter Costello MP, Treasurer, by Miller J and Davies R of 4BC Radio on 23/02/04 transcribed at http://www.treasurer.gov.au/tsr/content/transcripts/2004/008.asp.
[13] See the commentary about potential regulation in Hoyle S., *'Greasing mortgage deals'*, Sydney Morning Herald, 24/01/04, at 37, 40.

3. Recommendations and conclusion

CUSCAL suggests that the distinction between ADI and non-ADI lenders is an important element to consider when assessing any potential reform to the housing finance market. It would be unfortunate if responsible and prudently sound ADIs were effectively punished in an effort to place some limitations on perceived substandard lending practices in other sectors of the lending market.

Therefore, CUSCAL urges the Productivity Commission to:

- consider the regulatory coverage of mortgage originators and mortgage brokers[14], many of whom compete directly with ADIs in the lending market but do not carry the same prudential, probity or disclosure requirements;
- consider the inclusion of property seminar activity within the operation of the *Financial Services Reform Act 2001*, which sets out standards of behaviour and disclosure[15]; and
- ensure that all lenders (including non-ADI lenders) are subject to comparable regulatory standards.

CUSCAL looks forward to reading the Productivity Commission's findings in response to submissions to its *First Home Ownership Inquiry* discussion paper. CUSCAL would be happy to provide further material or answer any queries that the Productivity Commission may have about this response in particular, or about the credit union sector more generally.

Please contact either Josh Moyes (tel: (02) 8299 9033) or myself (tel: (02) 8299 9053) if you would like to discuss the points raised in this response.

Yours sincerely

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Industry Association
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[14] State and Territory governments are currently developing proposals to provide for uniform regulation of the mortgage and finance broking industries, with a working group due to report in March 2004.
[15] ASIC and ACCC are due to release a report considering this recommendation in March 2004.