

21 December 2004

NCP Inquiry  
Productivity Commission  
PO Box 80  
Belconnen, ACT, 2616

By email: ncp@pc.gov.au

Dear Sirs/Madams

**Submission #3 to the Productivity Commission's Public Inquiry on the "Review of National Competition Policy Arrangements"**

This submission represents an addendum to this writer's second submission to the Inquiry. The following represents additions, along with an amendment, under the respective section headings of the writer's second submission.

**Within the preamble section (page 1)**

Ian Macfarlane, Governor of the Reserve Bank has said "*there has been a step-by-step reduction in credit standards in recent years... and if present trends continue we could have one (an urgent problem) in a few years*" (speech "Monetary Policy and Financial Stability", 16/11/04). The IMF has found that major banking crises in industrialised countries tend to coincide with a housing price bust. Were a banking crisis to occur in Australia, pressures could mount to turn back the competition agenda and re-regulate the banking or financial system<sup>1</sup>, along with other sectors of the economy. The PC should consider this when finalising the final report of the Inquiry.

**5. Other implications of the housing price-debt boom**

In the event of the housing price-debt boom causing a banking crisis in Australia, the business sector may find it difficult to access finance. Any consequential re-regulation of the financial system may also have an effect on the availability and allocation of finance.

**6. Regulation and prudential oversight of housing finance**

***Risk weighting for loans secured against residential property***

To qualify for the concessional 50% risk-weight, the ratio of the outstanding amount of the loan to the value of the mortgaged residential property securing the loan must not exceed 80 per cent unless the loan is 100 per cent mortgage insured through an acceptable mortgage insurer. There would appear to be a couple of anomalies here:

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<sup>1</sup> The author of "Australia's Money Mandarins", Stephen Bell was recently interviewed on 3LO radio. To my recollection, Mr. Bell interviewed the Governor of the Reserve Bank for his book, and the Governor may have specifically pointed to the potential for re-regulation of the financial system

- Firstly, no consideration is given to the level or gradation of risk. If the loan to value ratio is 10% or 79%, the risk-weight would ordinarily be 50%; while if the loan to valuation ratio is 81%, the risk-weight would be 100% (in the absence of mortgage insurance).
- Secondly, while loans secured against claims (contingent, such as mortgage insurance, or otherwise) on companies are usually weighted at 100%, in the case of a loan also secured against a residential mortgage, it appears to be, in effect, risk weighted at 50%<sup>2</sup>.

There appears to be no specific prudential guidelines (much less on specific risk-weights) with respect to a new product offer by ADIs which allows “seniors” to borrow against the security of their home, where there is no obligation on the borrower to make repayments on the loan (i.e. interest is capitalised).

Yours faithfully

Nigel Fitzpatrick

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<sup>2</sup> The prudential guidelines on risk weighting are complex and should be checked with APRA (APRA did not respond to my most recent request for clarification of risk-weights)