



SUBMISSION BY THE  
Housing Industry Association

to  
**The Treasury**  
on the  
**Financial System Inquiry Terms of Reference**

4th December 2013

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## HIA

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HIA is the leading industry association in the Australian residential building sector, supporting the businesses and interests of over 40,000 builders, trade contractors, manufacturers, suppliers, building professionals and business partners.

HIA members include businesses of all sizes, ranging from individuals working as independent contractors and home based small businesses, to large publicly listed companies. 85% of all new home building work in Australia is performed by HIA members.



## 1. Introduction

The Housing Industry Association (HIA) welcomes the opportunity provided by the Treasury to contribute to the development of the Terms of Reference for the Financial System Inquiry.

The HIA's key concern is that policies facilitate the industry in the provision of affordable housing. Accordingly, our suggested amendments to the TORs have been formulated with this objective in mind. The HIA's main interest in the financial system is that it operates to allow the affordable acquisition of homes for prospective buyers. It is also important that the system functions in a way that supports the operation of small businesses around Australia. Finally, the continued long term development of Australia's economy and living standards is something a well-functioning financial system must serve.

Accordingly, our suggested amendments to the Draft TORs reflect a number of considerations which are discussed below. These include:

- Competitive issues in financial services;
- The role of Superannuation; and
- Product innovation in the financial system.

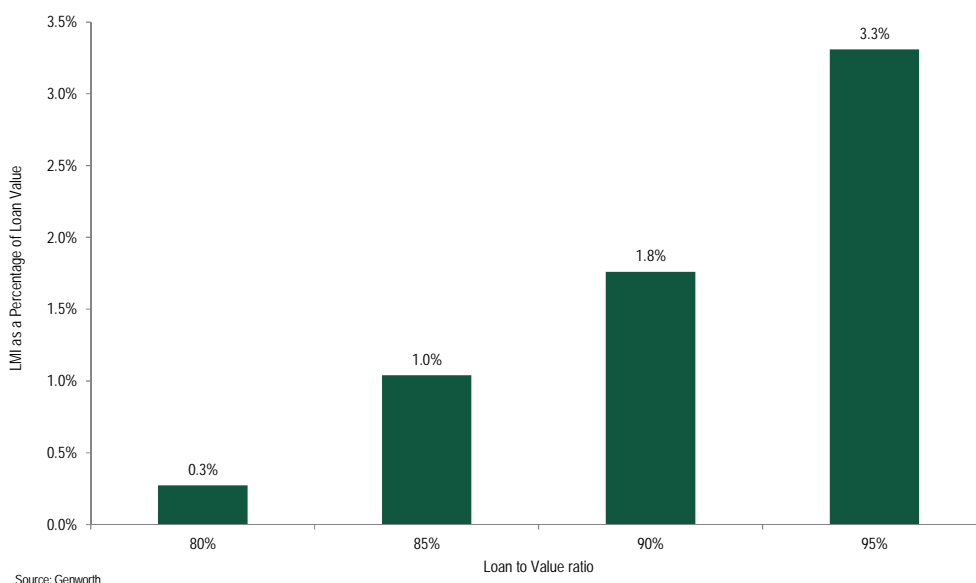
We look forward to our inputs being considered by the Treasury in finalising the Terms of Reference for this important inquiry.

## 2. Competitive issues in financial services

There is evidence that competitive constraints in the financial system are having detrimental effects on the prices paid by household and small business customers. Recent evidence of this includes the incomplete pass through of RBA cash rate reductions to these customer segments. Between late 2011 and the end of 2013, the RBA reduced rates by 225 basis points. Over the same period, the discounted variable mortgage interest rate was reduced by only 195 basis points while the small business overdraft rate was brought down by only 170 basis points.

Another possible case of excessive pricing resulting from competitive constraints exists in the market for Lenders Mortgage Insurance (LMI). LMI is a product which compensates mortgage lenders in the event of a loss being suffered on the disposal of loan collateral. It is charged to the borrower at loan origination stage and is general added to the mortgage principal, resulting in higher monthly repayments. LMI is generally applied only when the LVR exceeds 80 per cent. The amount of the premium rises in proportion to mortgage value, the LVR and the term of the mortgage. As the chart below shows, the premiums can be very substantial in some situations. In the case of major LMI provider Genworth, premiums range from 0.3 per cent of loan value at 80 per cent LVR to 3.3 per cent of the mortgage at 95 per cent LVR.

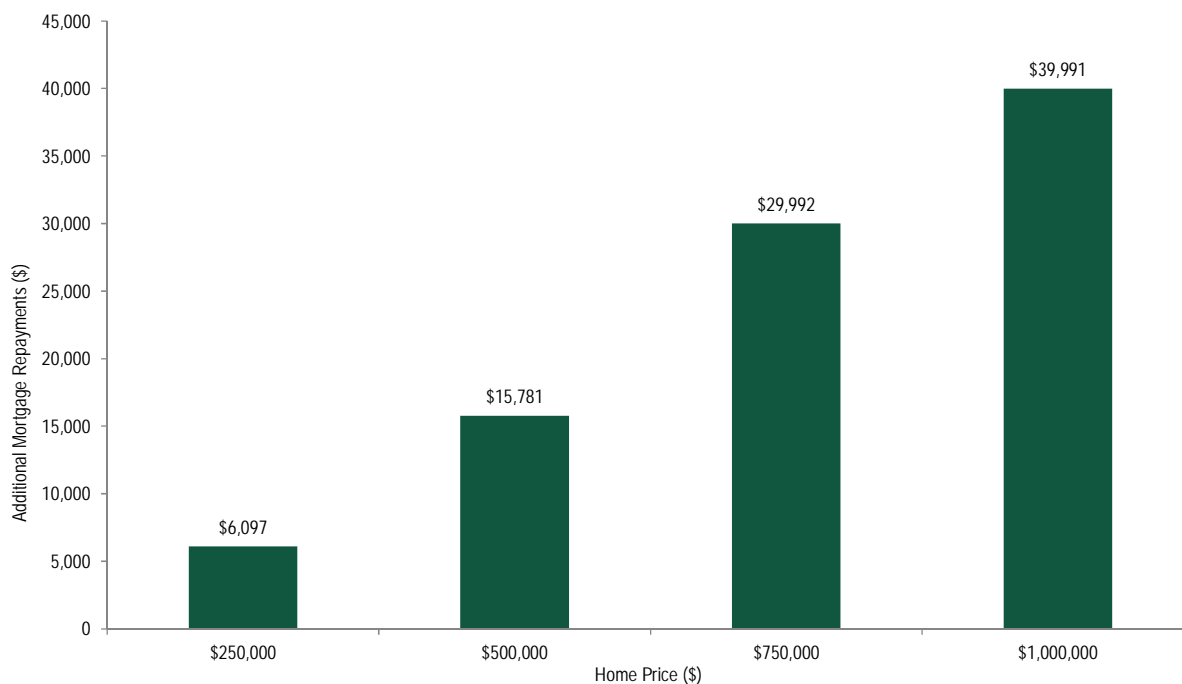
LMI as a Share of Loan Value on \$500,000 Home Purchase (<= 30 year Term)





In terms of the cash value, the additional mortgage repayments resulting from the imposition of LMI are shown in the chart below. For a thirty year mortgage with 90 per cent LVR, the repayments on a \$250,000 home are increased by \$6,097 as a result. For a \$750,000 home, mortgage repayments will increase by a total of just under \$30,000. LMI increases mortgage repayments by about \$40,000 on a \$1m home.

Additional Mortgage Repayments due to LMI (90% LTV, 30 Year Mortgage Term)



Source: Genworth

### 3. The role of Superannuation

It is estimated that approximately \$1.5 trillion is currently invested in Superannuation and this is likely to increase much further. These funds represent a massive resource which can drive long term growth in Australia's economy. Apart from home purchase, superannuation represents the single most important investment by Australian households. Accordingly, it is important that the cost structure, competitive position and product range offered by the industry is fine-tuned to allow the achievement of maximum return to the consumer given their risk preference. It is also important that superannuation products allow for supply-side bottlenecks in the economy to be overcome.

From the housing industry's perspective, the provision of support infrastructure like access roads, utilities connections, telecommunications and community facilities for new housing represents a major constraint on the capacity of the sector to meet increased demands for housing. Superannuation funds have the potential to finance much of the necessary housing support infrastructure. The availability of such an investment option would be suited to superannuation investors seeking a relatively low risk, stable income product. Such investment would have the important benefit of adding to the physical capital stock, boosting the long term economic potential and enhancing the return to all Australian-based asset classes in superannuation portfolios.

### 4. Product innovation in the financial system

The potential for superannuation to fund housing support infrastructure and other elements of Australia's capital stock highlights the opportunities presented by financial product innovation. Products like tailored infrastructure bonds would allow both superannuation and non-superannuation investors to provide upfront funding. In return, they would receive a portion of the revenues received from users of the infrastructure. This product could be configured further to allow infrastructure bonds to be individualised



by class of asset (roads, community facilities, utilities networks, etc.) or by geographic location (Sydney, Melbourne, etc.).

Financial product innovation in the post-inquiry context may also support higher rates of home ownership. Home purchase inevitably entails a degree of risk for the buyer, particularly when financed by mortgage borrowing. The existence of these risks may dissuade potential home buyers from entering the market. Innovation in financial products may provide methods of controlling for these risks, allowing such households to enter the market.

## **5. Conclusion**

The HIA looks forward to working with the Financial System Inquiry team as required over the coming twelve months in order to deliver on the final Terms of Reference. We emphasise the importance to a suitable focus on how superannuation funds can best be leveraged, in addition to enhancing competition and innovation in financial services as a means of supporting stronger outcomes in the housing sector and the wider economy.

# Financial System Inquiry – Draft Terms of Reference (suggested HIA amendments)

## OBJECTIVES

The inquiry is charged with examining how the financial system could be positioned to best meet Australia's evolving needs and support Australia's economic growth.

Recommendations will be made that foster an efficient, competitive and flexible financial system, consistent with financial stability, prudence, integrity and fairness.

## TERMS OF REFERENCE

1. The Inquiry will report on the consequences of developments in the Australian financial system since the 1997 Financial System Inquiry and the global financial crisis, including implications for:
  - 1.1. how Australia funds its growth;
  - 1.2. domestic competition and international competitiveness; and
  - 1.3. the current cost, quality, safety and availability of financial services, products and capital for all end users.
2. The Inquiry will refresh the philosophy, principles and objectives underpinning the development of a well-functioning financial system, including:
  - ~~2.1. balancing competition, innovation and efficiency, with stability and consumer protection;~~
  - 2.1. balancing competition, innovation and efficiency, with stability and consumer protection;
  - 2.2. Exploring the viability of alternatives to the current 'four pillars' market structure;
    - ~~2.2.2.3.~~ 2.2.3. how financial risk is allocated and systemic risk is managed;
    - ~~2.3.2.4.~~ 2.3.4. assessing the consequences of financial regulation, including its impact on compliance costs, flexibility, innovation and financial services trade;
    - ~~2.4.2.5.~~ 2.4.5. the role of Government; and
    - ~~2.5.2.6.~~ 2.5.6. the role, objectives, funding and performance of financial regulators.

3. The Inquiry will identify and consider the emerging opportunities and challenges that are likely to drive further change in the financial system, including:

3.1. the role and impact of new technologies, market innovations and changing consumer preferences and demography.

~~3.1.3.2.~~ long term ageing of the population and the increasing importance of issues around superannuation funds;

~~3.2.3.3.~~ international integration, including international financial regulation;

~~3.3.3.4.~~ changes in the way Australia sources and distributes capital, including the intermediation of savings through banks, non-bank financial institutions, insurance companies, superannuation funds and capital markets;

3.5. changing organisational structures in the financial sector;

~~3.4.3.6.~~ the continued need to expand long term economic infrastructure and the opportunities for the financial sector to develop related funding mechanisms;

~~3.5.3.7.~~ corporate governance structures across the financial system and how they affect stakeholder interests; ~~and~~

~~3.6.3.8.~~ developments in the payment system.

4. The Inquiry will recommend policy options that:

~~4.1. promote a competitive and stable financial system that contributes to Australia's productivity growth;~~

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~~4.2. promote the efficient allocation of capital and cost efficient access and services for users;~~

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4.3. support individuals and businesses to be reasonably able to manage their finances by understanding risks and rewards in the financial sector;

4.4. enhance transparency in the sector around pricing and terms of service;

~~4.3.4.5.~~ assist the development of products catering for the full range of risk preferences amongst users of financial services;

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4.4.4.6. foster dynamic and innovative financial service providers; or

4.5.4.7. relate to other matters that fall within this terms of reference.

5. The Inquiry will take account of the regulation of the general operation of companies through corporations law to the extent these impinge on the efficiency and effective allocation of capital within the financial system.

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6. The Inquiry will examine the taxation of financial arrangements, products or institutions to the extent these impinge on the efficient and effective allocation of capital by the financial system, and provide observations that could inform the Tax Policy White Paper.
7. In reaching its conclusions, the Inquiry will take account of, but not make recommendations on the objectives and procedures of the Reserve Bank in its conduct of monetary policy.
8. The Inquiry may invite submissions and seek information from any persons or bodies.
9. A final report is to be provided to the Treasurer by 1 November 2014, following an extensive period of consultation. Consultation will include the publication of an interim report that communicates the Committee's predispositions, allowing adequate time for interested persons or bodies to provide input to the final report.