REIA

REAL ESTATE INSTITUTE OF AUSTRALIA

The Real Estate Institute of Australia

Submission to The Treasury on the **Financial Claims Scheme Consultation Paper**

Prepared by the Real Estate Institute of Australia

June 2011

The Real Estate Institute of Australia
16 Thesiger Court I PO Box 234, Deakin ACT 2600
Phone 02 6282 4277 I Fax 02 6285 2444
www.reia.com.au I reia@reia.com.au

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Phone (02) 6282 4277 I Fax (02) 6285 2444
ABN: 81008652597

FINANCIAL CLAIMS SCHEME CONSULTATION PAPER

Background

The Treasury is seeking submissions on its Consultation Paper on the Financial Claims Scheme.

REIA represents around 80% of real estate agencies and is an important element of the broader property and construction sector, which makes a significant contribution to Australia's social climate and economic development. The real estate profession employs approximately 77,000 persons with most agencies having less than 10 employees and contributes $300 billion annually in economic activity.

REIA has the commitment of providing and assisting research and well-informed advice to the Federal Government, Opposition, professional members of the real estate sector, media and the public on a range of issues affecting the property market.

Issues

In responding to the Consultation Paper the REIA welcomes the opportunity to be part of the process and address the following issues:

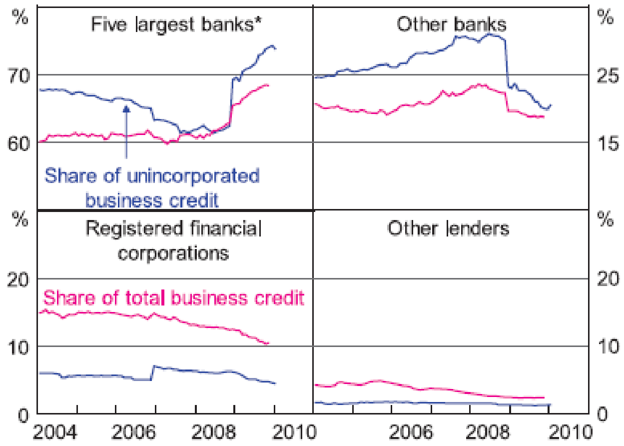
- the cap on the Financial Claims Scheme from October 2011
- additional coverage to depositors whose funds are held in selected pooled trust accounts current.

<u>The cap on the Financial Claims Scheme (FCS) from October 2011</u>

That competition in the banking sector has declined following the GFC can be seen by the increase in concentration of credit in a few financial institutions and by the increase in lending margins by the major banks relative to the small ones. The changes in the concentration of business lending and net interest rate margins (NIM) by the major banks indicate that small lenders were being pushed out of the market and the big four banks were consolidating their market power.

Chart 1: Lenders' share in business credit

Per cent

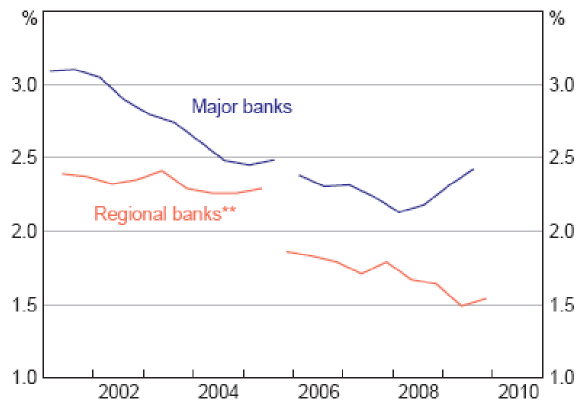


Source: RBA-Submission to the Inquiry into Access of Small Business to Finance, March 2010

Chart 1 above shows the changes in the lenders' share of business credit over the period 2004-2009. The big five banks – including Bank West from Dec08 – significantly increased their share from around 60 per cent in 2004 to around 75 per cent in 2009, while other lending institutions (other banks, registered financial corporations and other lenders) lost market share during the same period.

There has also been a widening in the lending margins by the major banks. Chart 2 below shows that major banks' NIM started to increase from 2008 while that of regional banks decreased relatively to major banks. The NIM for the major banks was around 20-25 basis points above pre-GFC levels whilst regional banks' NIM was around 20 basis points lower than in mid 2007[1].

Chart 2: Banks' Australian Net Interest Margin



Source: Recent Developments in Banks' Funding Costs and Lending Rates, RBA March Quarter Bulletin, 2010

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[1] Brown A, Davies M, Fabbro D and T Hanrick. Recent Developments in Banks' Funding Costs and Lending Rates, RBA Bulletin, March 2010.

In relation to profits, according to Dr. Ken Henry – immediate past Secretary to the Treasury – "all Australian financial institutions have experienced a drop in profits as a result of the crisis, but the fall has been more pronounced for smaller institutions"[2].

The increase in market concentration by the major banks can be explained by several factors such as:

- Mergers and acquisitions in the banking sector
- Higher bank funding costs
- Closure of securitisation markets and constraints in other funding markets.

Lack of competition in the banking industry brings about credit restrictions and higher funding costs. There is evidence that bank concentration increases financing obstacles and decreases the likelihood of receiving bank finance. In business, this results in small businesses being more affected compared to large firms[3]. This is in part because large firms are more likely to be dominant in their markets and are more likely to pass on higher funding costs and partly because they have access to capital markets.

REIA is concerned that reducing the deposit guarantee cap level to between $100k and $250k would have a negative impact on the level of competition in the financial sector. Any move that reduces the competitiveness of the smaller financial institutions could be harmful to the Australian economy, particularly at this time with concerns about the "two-speed economy".

Responses to a survey the REIA conducted in March 2010 indicated that the decrease in competition in the finance market post the GFC had a debilitating affect on many real estate agencies.

If the proposal is implemented this could lead to a large redistribution of deposits towards the larger institutions.

Further the proposed lower threshold is too low for the size of accounts held by real estate agents. With around $1 billion held in trust by the industry for buyers and sellers in any one year and with the majority of Australia's real estate agents having trust accounts in excess of $1 million the proposal does not acknowledge the needs of the real estate industry. With the median price of housing currently $532k it would take only two normal 10 per cent deposits to have exceeded the $100k proposed guarantee cap. If implemented the impact on the industry and the individual is not insignificant.

REIA is firmly of the view that the size of deposit covered by the Financial Claims Scheme should not be reduced from its current level of up to $1 million per depositor per authorised deposit-taking institution.

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[2] The Australian Financial System – Emerging from the Global Financial Crisis, Address to the Count Financial Canberra Conference, March 2010.

[3] Bank Competition, Financing Obstacles and Access to Credit. The World Bank, Development Research Group, March 2003.

Pooled Trust Accounts

The REIA welcomes the proposed changes in relation to trust funds that provide for the funds of each beneficiary to be treated as if they were held in separate trust accounts, with the same trustee for each account. This is a vast improvement on the current situation where the accountholder (the trustee) is entitled to one payout up to the cap, even though the account may contain funds held on behalf of a large number of beneficiaries, which is the case with real estate agents.

The need for this proposal would become even more acute if as is being suggested by the Discussion Paper the cap for the level of cover by the FCS is reduced.

REIA supports the proposal for the FCS to be amended to allow it to 'look-through' pooled trust accounts held by authorised deposit taking institutions so that the cap applies to individual beneficiaries rather than the account as a whole.

REIA Recommendations

The REIA recommends that Government:

1. ***Not reduce the size of deposit covered by the Financial Claims Scheme from its current level of up to $1 million per depositor per authorised deposit-taking institution.***

2. ***Adopt the proposal to "look–through" pooled trust accounts and make payments up to the cap for each beneficiary.***

Prepared by:

Secretariat REIA
June, 2011