Financial Services and Credit Reform: Improving, Simplifying and Standardising Financial Services and Credit Regulation (June 2008).

Comments on proposals set out in the Green Paper by Fujitsu Consulting, June 2008

Introduction

1. Fujitsu is a Global Business and IT Services Company. Fujitsu Consulting is a business unit within the Australian and New Zealand operations.

2. In Australia we have specialised in the Financial Services sector through our many consulting engagements in Mortgages, Credit Cards and Small and Medium Business. We have been engaged by Major Banks, Regional Banks, Non-Banks, Aggregators and Platform Players. From these engagements we maintain industry models which track and compare the revenue and cost footprints across the industry. We supplement this with primary research through our omnibus surveys of consumers, small business owners and mortgage brokers. Finally, we draw on our global research to benchmark the performance of the industry here compared with analogous markets in the UK, Canada and USA.

3. We publish regular research reports, including a twice a year joint study with JP Morgan on the Mortgage Industry, Small Business Finance, one-off reports on the Anatomy of Mortgage Stress, Lending Predation, and monthly statistics on Mortgage Stress using our Mortgage Stress-o-Meter methodology.

4. As a result we have a thorough and independent view of the current state of the industry and we welcome the opportunity to provide comments on the Green Paper. We will focus our input on those areas where we have deep insight, namely the mortgages, mortgage broking and non-deposit taking institutions (Section 1 of the Green Paper).

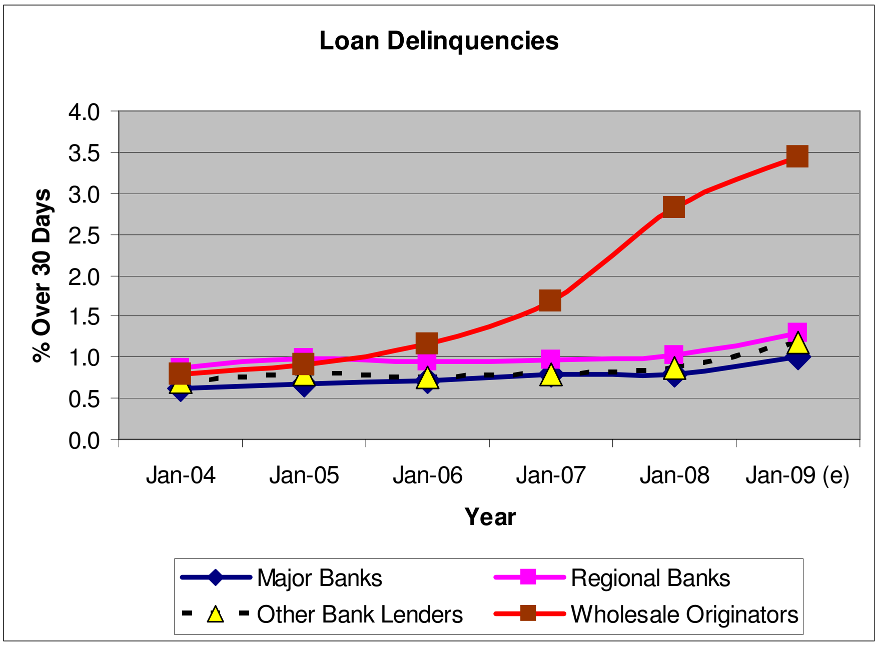
Current Situation

The Green paper, in our view sets out the current situation appropriately. However, there are a number of additional data points which we believe would assist policy makers.

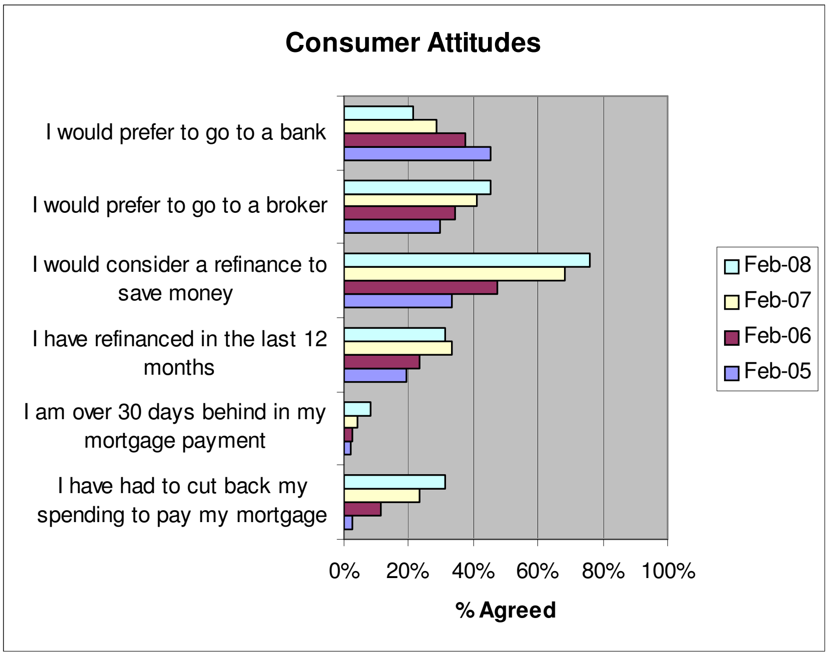
1. In the last few months we have seen the Major Banks reasserting their market power, as Wholesale Lenders and Non-Banks have ceased or reduced their marketing and lending efforts as a direct result of the Credit Crunch and the evaporation of the Securitisation markets. Our estimate is that in May and June 2008 as much as 90% of new lending was directed to the Majors. As a result competitive tension is lower now than at any time in the last 10 years.

2. There is evidence that some Major Banks have been able to lift their margins on some loans by 100-130 basis points, even allowing for increased funding costs directly related to the Credit Crunch, and RBA rate increases. This is true of some mortgage lending, as well as in the Small Business sector. Indeed, we note that some players have started comparing their loan rates with overseas rates, rather than the local cash rate.

3. Prior to the Credit Crunch, Wholesale Originators were able to source funds cheaper than the Traditional Players, and were willing to make larger loans to more risky clients, including low-documentation loans. As a result, our modelling indicates that now, losses in this sector are rising significantly, compared with the rest of the industry. Whilst overall losses remain at low levels by international standards, these higher losses are further diluting the ability of Non-Banks to participate in the market.

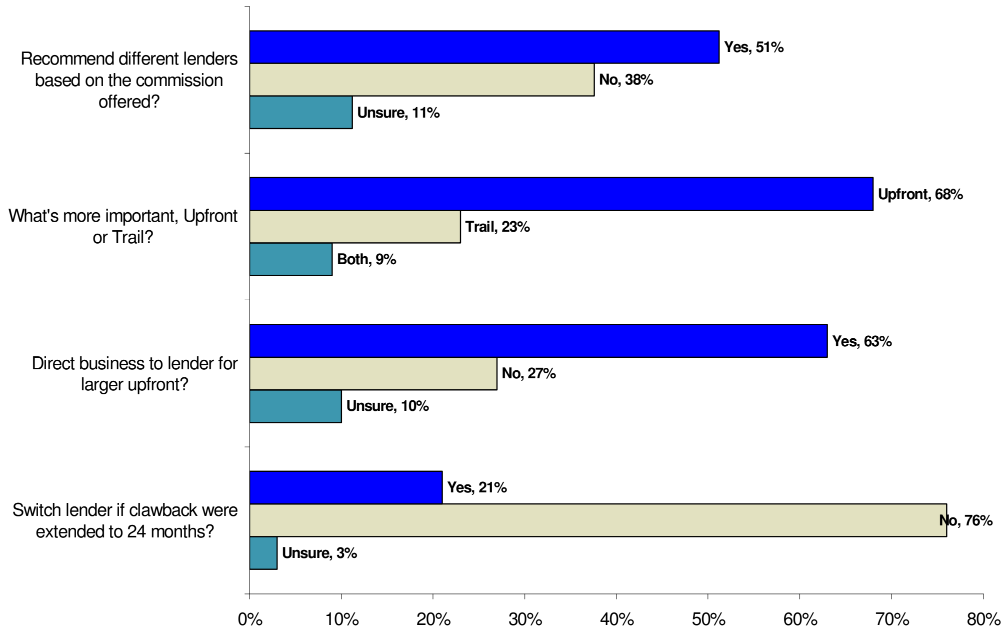


4. There is strong evidence that consumers value the services of Mortgage Brokers. They believe they obtain objective and independent



advice from Brokers. Of note is the steady rise in recent years of consumers who prefer to use Mortgage Brokers.

5. In contrast, our Broker research highlights that Brokers will tend to recommend loans from a small selection of panel lenders (say 3-4) even if there is a theoritical broader range available and they are



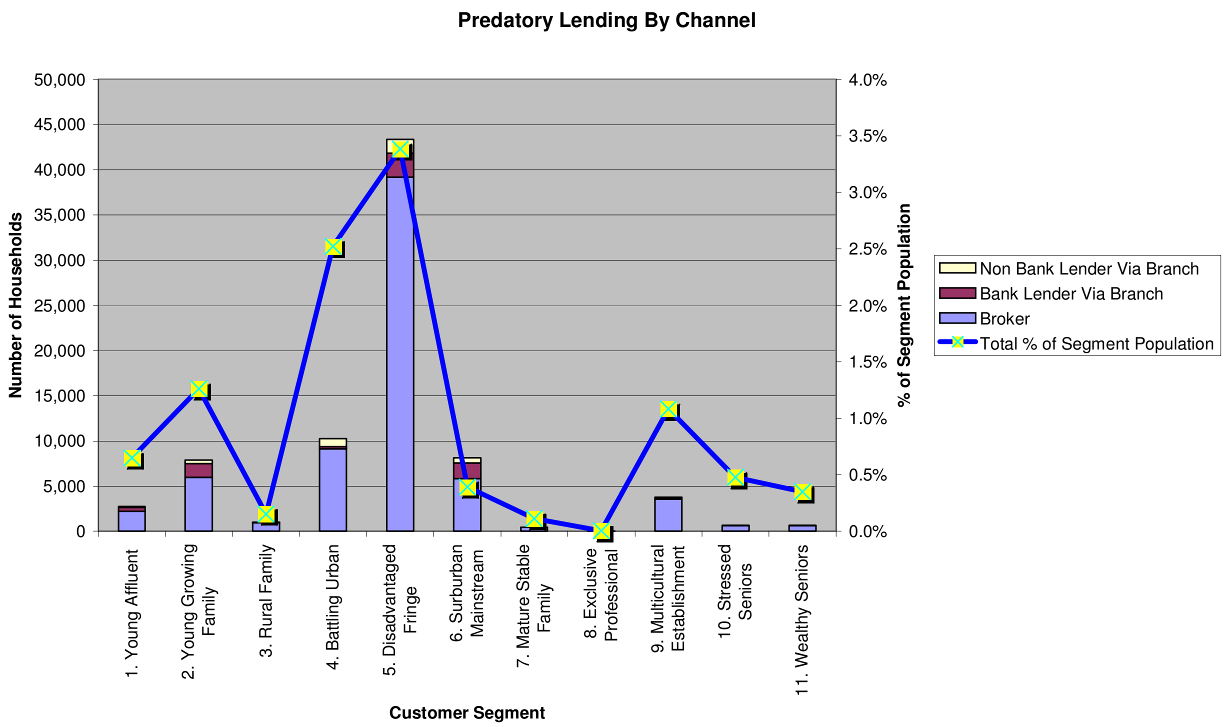
heavily influenced by the commissions they receive. In our Broker survey (10% of brokers) the upfront commission was the most significant element in influencing choice of lender. This is supported by annecodotal evidence. When Westpac announced it would cut its broker commissions, one well known Aggregator emailed is brokers saying they should no longer recommend Westpac loans.

6. Predation in Australia, meaning consumers are being sold the wrong loans, is increasing.

Leading indicators of predatory lending could include:

- Lending to consumers with poor credit histories
- Excessively high set up costs, especially if financed as part of the loan
- Excessive advice fees
- Pressure to sign the documentation without proper explanation
- High ongoing interest rates
- False categorisation as a business or investment loan to avoid the Consumer Credit code
- Reliance on assets rather than income to meet loan repayments
- Embedded conditional fees which are not transparent
- Presence of an intermediary such as a mortgage broker
- Consumers advised to make false declarations on application forms (for example overstating income)
- Swift enforcement action upon default
- Pressure to refinance

In our latest resarch, the number of households predated has risen to 79,000, up from 40,000 in August 2007. 68,000 of these households have been predated by a Mortgage Broker.



7. There is a fundamental disconnect between consumer expectations and broker behaviour. At its heart is the ambiguity which can be highlighted by simply asking the question, "for whom does the Broker work?" The Broker is not the agent of the consumer, nor the bank, and there is no obligation to provide BEST ADVICE to consumers

8. We believe consumers are paying up to 30-35% more than they should for their mortgages. According to our cost and revenue benchmarking, Banks in Australia are enjoying higher margins and fees compared with players in the UK and USA, and are significantly less efficient than overseas players, with the overall industry costs 25-30% higher than in the UK. In our view this is explained mainly by the lack of competitive tension in the Australian markets, a rise in conditional fees, and inefficient processes (in Australia some players have loan rework rates of 60%, compared with 5% in UK). There is therefore a significant cost to "Australia Inc" because of the inefficiencies in the industry. This has been covered in detail in our Mortgage Industry reports.

Comments on Green Paper Recommendations

1. We believe that revised regulation is required, and that Option 3 is the most appropriate path to take. To a large extent, it mirrors the steps taken in recent years in the UK by the Financial Services Authority (FSA). State-based regulation is hard to orchestrate, as illustrated by the slow progress in Broker Regulation.

2. We believe it is essential to establish definitively the relationship between the Mortgage Broker, the Consumer and the Lender. We believe the right option is to make the Broker the agent of the Consumer and to impose an obligation of providing BEST ADVICE to Consumers. This would have significant benefits in terms of sharpening competitive tension in the industry, reducing the potential for predation, and defining the scope of disclosure.

3. We believe there is merit in the UK practice of requiring Lenders and Brokers to provide a Key Facts Document for each Mortgage recommendation. Essentially this is a standard document which explains the nature of the loan, the reasons why the loan is appropriate, and the various elements in terms of fees, commissions, and business terms. However, we note that the UK document is quite long – at least eight pages – and is required for each Mortgage recommendation. Consumers may need to wade through many documents if they are to make valid comparisons, In addition recent research has shown that the costs of writing a loan has increased significantly and compliance with the FSA regulations are still low. The right answer may be a shorted form of documentation, with a focus on key comparative data and disclosure.

4. We believe that a holistic basis of comparison is required. Perhaps we could learn from the total costs disclosure regime used in the Mobile Phone industry. If we were to take the average Loan size and duration in Australia, it would be feasible to create a standard model where all costs, fees, commissions, interest and conditional fees could be rolled up into a single dollar comparison. This would avoid the pitfalls on the current comparison rate approach which bears little relationship to the true costs of a loan.

5. We believe that the right model for BEST ADVICE is where Brokers receive a payment from the consumer for advice, rather than a commission from a Lender. It is difficult to envisage a situation where commissions if paid will not influence the advice. There is a question whether full disclose of commissions, including soft commissions and quotas are sufficient. In the UK, the proportion of Brokers who provide independent advice for a fee are rising. Brokers can choose this model, or be tied to Lenders, in which case they cannot claim to provide BEST ADVICE.

6. The change in regulation as suggested will reduce the number of Mortgage Brokers in the industry. The UK experience was that half the Brokers (20,000 down to 10,000 in 18 months) left the industry. Those which remained tended to aggregate around larger players, and this has led to a concentration in ownership and a significant reduction in the number of small independent Brokers. We would expect similar outcomes in Australia and so would expect the number of Mortgage Brokers here to fall from 11,000 to 6,000. There is clearly a risk that such regulation could reduce consumer choice, but our view is that the BEST ADVICE philosophy would enable the industry to service consumers more appropriately.

7. We believe it is essential to increase competitive tension in the industry to drive down margins and fees, and to ensure there is adequate focus on driving cost efficiency. Our modelling suggests this is less a factor of scale (in other words the four pillar policy is not the reason for lack of efficiency) but rather need and intent. Major Players in Australia have enjoyed relatively easy competitive dynamics, and as described earlier, Wholesale Lenders have become less able to increase competition. Players in the UK have been able to make adequate shareholder returns on a margin of 50-60 basis points. The margins in Australia are still significantly higher.

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