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Senate Standing Committees on Economics
PO Box 6100
Parliament House
Canberra ACT 2600

Email: economics.sen@aph.gov.au

Question on Notice Response

Thank you for the opportunity to provide more detailed information following our appearance at the Inquiry regarding the different capital treatment Lenders Mortgage Insurance (LMI), the Home Guarantee Scheme (HGS) and Parental Guarantee loans.

Capital Treatment across low-deposit solutions

As outlined in our original submission, unequal capital requirements are applied to high loan-to-value ratio (LVR) loans utilising lenders' mortgage insurance (LMI), the Home Guarantee Scheme (HGS) and Parental Guarantees.

To illustrate the point, the standard risk weight for a **\$600k property, at a 95% LVR (i.e., 5% deposit, \$570k loan)** is **70%**. The risk weights across various low deposit solutions available as well as the capital requirements for this scenario are outlined below:

Bank capital required	No Lenders Mortgage Insurance	Lenders Mortgage Insurance	With First Home Guarantee	With Parental Guarantee
Variance to standard risk weight (70%):	0%	-15%	-35%	-35%
Risk weight:	70%	55%	35%	35%
Capital held by Bank ¹	\$45,885	\$36,053	\$22,943	\$22,943
Capital held by LMI provider ²	\$0	\$16,956		
Total Capital supporting loan	\$45,885	\$53,009		

As illustrated, the capital held by the Bank for a HGS or Parental Guarantee for this loan is **\$22,943** which is significantly less than the capital held for the same value loan using LMI which is **\$53,009** (\$36,053 Bank + \$16,956 LMI provider).

¹ Assumes bank holding capital at 11.5% of risk weighted assets

² Based on LMI regulatory capital requirements for insurance risk

Lower capital requirements reduce banks cost of funds and therefore overall cost of lending, all else being equal, this should enable lenders to pass on these savings through lower interest rates to borrowers. Inconsistent capital requirements that require lenders to hold different levels of capital for the same underlying risk, depending on the risk reduction tool employed, are likely to ultimately result in market inefficiencies and distortions in lending costs and availability.