SUBMISSION 2

MFAA
MORTGAGE & FINANCE ASSOCIATION OF AUSTRALIA

Enquiry into Home Loan Lending Practices and Processes

Submission by Mortgage and Finance Association of Australia – 17 July 2007

The Mortgage and Finance Association of Australia (MFAA) is Australia's peak industry body for the mortgage and finance industries. The MFAA is pleased to participate in this enquiry.

The MFAA's membership of 12,800 comprises mainly mortgage and finance brokers and mortgage managers, but also bank and non-bank lenders

Brokers have little to do with establishing lending practices and processes. They sell the products made available by lenders. So, if there has been a change to lending criteria, these are generally changes made by lenders.

Our key submission is that while the high cost of homes coupled with falling house prices in some markets have attracted much attention in the press and are no doubt causing some borrowers difficulties, these factors do not indicate any conduct which needs to change in Australia's mortgage industry. They do not indicate a material presence of predatory lending or other improper practices. Of course, there are fringe lenders who abuse the system, but that is not widespread, and could be at least partly addressed by requiring all consumer lenders to be a member of an ASIC approved dispute resolution scheme such as COSL.

We have addressed the four issues raised in your invitation under separate headings.

1. To what extent have credit standards declined in Australia in recent years?

- **Market share of non-conforming lenders.**
- **Increase in low-doc products across the board.**

Key points:

- Low doc products are made available by both non-conforming lenders and prime lenders.
- New products and the emergence of non bank lenders have increased competition and reduced margins, providing a benefit for borrowers.
- Credit is significantly easier to obtain as a result of increased competition. This competition has led to changed credit standards and processes, but change does not mean that there has been a decline (ie worsening) in credit standards to the detriment of consumers, as evidenced by the continuing low default rate.

The following definitions are provided. (These terms are not used consistently which can create confusion).

Non-conforming products are loans to borrowers with an impaired credit history (eg previously bankrupt, or previous loan defaults). Some commentators use this term to include loans to borrowers with a clean credit history but who fail to meet prime lender's criteria (eg self employed, immigrant, older borrowers).

Low doc products are loans where a full verification of the borrower's income is not required but the ability to service the loan is tested against the income stated by the borrower.

No doc loans are loans where there is no verification of income at all, but the ability to service the loan is tested against the income stated by the borrower.

Asset lending refers to loans where no investigation is made in relation to the borrower's ability to repay and the lender relies on the security offered to recover its loan.

Low doc, no doc, and asset lending products are available from many lenders, including both bank and non-bank lenders. Non-conforming loans are usually available from specialist lenders only.

Credit is significantly more freely available than it has been previously. In the 1980's, even wealthy Australians found it difficult to secure a home loan and were required to meet stringent tests such as being a member of a Permanent Building Society for many months or even years.

The increased availability of credit has not been sudden, and has not been accompanied by any marked reduction in credit standards or increase in delinquencies. There has been a slow but constant development of new products and new sources of finance. One of the new sources of finance is securitisation which was used by Aussie Home Loans to increase competition and reduce lending margins. Generally, borrowers benefited from these changes.

At the same time, debt has become a commodity for Australians. As recently as 10 years ago, debt was considered a bad thing and conventional wisdom was to repay debt as fast as possible. Now, debt is a commodity acquired or repaid as desired and used by Australians to make lifestyle decisions involving real estate, goods purchases, and investments.

Before growth in sources of finance and products available, borrowers often resorted to high interest rate loans and so-called "solicitor money". Solicitor money was typically asset lending. There was little or no enquiry into the borrower's ability to repay. In relation to these loans, credit criteria has tightened as the bulk of lenders (at least for consumer lending) now want to satisfy themselves that the borrower will be able to repay without due difficulty. Lenders who do not undertake that enquiry for UCCC regulated lending risk the loan being varied or set aside as unconscionable.

Standards in lending are very high, due to consumer friendly regulation (UCCC), more coordinated professional bodies (MFAA), strong dispute resolution schemes (COSL and BIOS), and an inherent motivation by lenders to get it right so that they can recover their loans.

Any decrease in lending standards is largely confined to unsecured lenders where loan numbers are high, loan sizes are small, and lenders can accept a certain level of loan write-offs.

There is no ascertainable link between non-conforming lenders entering the market and increased defaults. Non-conforming lenders have introduced new, and in some cases reduced, credit standards for mainstream lending. These borrowers were previously forced to borrow more expensive non-mainstream money, or be deprived the opportunity to buy their own home or develop their business.

2. Have declining credit standards caused an increase in the number of loans in arrears and the number of repossessions?

- **Lack of accurate data on repossessions.**
- **'Agreed' sales hiding true rate of defaults.**

Key points:

- There is no accurate data on repossessions or forced sales.
- There is no demonstrable link between declining credit standards and increased loan arrears (and we consider there is no evidence of declining credit standards).
- There is no clear evidence of any increase in the number of loans in material default.

As we believe there are no declining credit standards, any increase in the number of loans is not linked to that factor.

Recent media reports of increased number of court actions for repossession in NSW are not an accurate guide to the level of default, or forced sales. Any increase in court actions may arise from a change in process by lenders or their lawyers. Most mortgage enforcements are concluded without the necessity of court action at all.

Therefore, there is no accurate data on repossessions or forced sales, and speculation in the media is often misleading. Some indication of the level of default (as distinct from forced sales) can be derived from the analysis of mortgage portfolios by ratings agencies in connection with securitisation. We understand that figures demonstrating Australia's low default rate by world standards will be provided by others at the round table. These figures show that the current level of arrears is within expectations and compare favourably to overseas (see Moody's – Australian Non – Conforming RMBS Performance Review: Q4 2006).

The reason for a borrower defaulting on their loan cannot be generalised as relating to interest rate increases or inappropriate lending. Most often, the reason is an unforeseen event in the borrower's life or business.

Levels of arrears and repossessions will increase and decrease at different times in the credit cycle and are also sensitive to interest rate levels, unemployment, inflation, economic activity, and house prices. The recent increase in the number of bankruptcies is driven largely by small business rather than consumer activity.

Overall loss performance of residential housing loans is expected to increase modestly in line with slowdowns in house price growth and depreciation in some areas. However, this is off historical lows, and is not expected to impact on the quality or operation of the mortgage industry.

3. Are borrowers in financial difficulty being treated appropriately by lenders?

- **Obligations under CBP and/or UCCC.**
- **Access to superannuation for repayments.**

Key points:

- Lenders are treating borrowers better than ever before and generally comply with the law.
- There are fringe lenders who cause problems, but they are a small minority.

Since the introduction of the UCCC in 1996, there have been significant reasons for lenders to work closely with defaulting borrowers. Prior to 1996 there was little regulation of mortgage lending. Lenders increasingly deal with problems in a sympathetic and solution driven way.

It is in the lender's best interest to work with borrowers who experience financial difficulty to maximise the outcome for both parties. Our experience is that the mortgage industry is more accessible and more consumer friendly than it has been at any time in the past.

A number of cases have recently clarified that consumers' rights are very strong in a default situation. It is likely that lenders are in a weaker position than ever before when it comes to enforcing rights.

There are isolated pockets of fringe lenders who lend money inappropriately, and similarly employ inappropriate recovery methods.

There is evidence of the growth of these fringe lenders who generally work outside the law or there is no law appropriately regulating them. These lenders typically charge high establishment fees and high interest rates. They can be quite unscrupulous in their dealing with defaults. Generally, these lenders are not members of the MFAA. The MFAA is working closely with the regulators and consumer groups to address the problems created by this small group. Much of the "bad press" arises from the conduct of this small group.

The MFAA considers that consumers will be assisted if all lenders of UCCC regulated lending must be members of an ASIC approved dispute resolution scheme. This would ensure the borrowers from the non-ADI sector would have recourse to have their complaints heard for free.

4. Are declining credit standards likely to have any long-term implications for the Australian financial system?

- **Lessons from the current situation in the United States.**

Key points:

- There is no evidence of declining credit standards.
- There is very little to be learned from the recent US experience.
- There are no long term implications for the Australian financial system.

There is very little to be learned from the recent US experience as the Australian and US markets are significantly different in terms of structure and participants. Sub-prime is very significant in the US, the US is largely a fixed rate dominated market, deeply discounted honeymoon periods are common, and in many states borrowers can "hand the keys back" and walk away from the debt with no financial recourse.

As we believe there are no declining credit standards (despite the change to credit standards), we consider that there are no long-term implications for the Australian financial system.

There are significant problems for first home buyers in Australia due to of the high price of land. Often this stems from the significant costs and risks associated with obtaining approvals and paying contributions and other development costs.

So called "mortgage stress" is a result of the high cost of homes rather than the behaviour of mortgage lenders. The high cost of homes coupled with falling house prices in some markets have attracted much attention in the press and are no doubt causing some borrowers difficulties, but these factors do not indicate any conduct which needs to change in Australia's mortgage industry.