The Hon Bruce Baird MP
Email: Bruce.Baird.MP@aph.gov.au

8 August 2007

Dear Sir,

Re House Economics Committee Inquiry into Home Loan Lending Practices

As the leading provider of specialty mortgages in Australia, Liberty Financial would like to provide input into the forthcoming inquiry into Home Loan Lending Practices.

Liberty was the first company to offer specialty (including sub-prime) mortgages in Australia, commencing in 1997. As such, we believe we may be able to share with you and the Committee insights gained from providing finance to many Australians who do not meet the criteria of traditional lenders.

There have been links made between home lending credit standards and increases in customer arrears and mortgage foreclosures. Whilst we are aware of these increases in the broader industry, at Liberty we have seen our arrears decline over the last twelve months.

We are concerned that what we perceive to be the primary issues leading to foreclosures are not being addressed.

In our experience, the credit standards used for certain low doc products and by unsecured lenders are encouraging customers who can not afford credit to borrow. For example, the growth in house prices and foreclosures over the last five years is closely correlated to the above system growth in low doc lending.

At Liberty low doc products are only available to self employed borrowers.

Customer benefit and the ability to repay loans is core to our business. In addition to UCCC requirements, which we take very seriously, it is in our interest to make sure that customers have the ability to pay, otherwise we wear the consequences.

It is our contention that many foreclosures and personal bankruptcies would be prevented if lenders exercised appropriate income verification standards, in particular for low doc and unsecured borrowers.

We have attached a document outlining our perspective on some of the above and we would welcome the opportunity to present more information either to the Committee or to the Chair and Secretary.

Yours sincerely,

James Boyle
General Manager – Australian Mortgages

CC: Andrew McGowan, Inquiry Secretary
Inquiry into Home Loan Lending Practices and Processes
House of Representatives Standing Committee
BY EMAIL: andrew.mcgowan.reps@aph.gov.au

LIBERTY FINANCIAL

Inquiry into Home Loan Lending Practices

8 August 2007

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Introduction

Liberty Financial was established in 1997, when it introduced non-conforming mortgages in Australia. Today, whilst still being responsible for nearly 40% of the specialty mortgage market, Liberty has expanded to include Asset Finance and Commercial products and services to its growing portfolio.

Liberty is a non-bank lender, not an Authorised Deposit-taking Institution (ADI), and is not regulated by the Australian Prudential Regulatory Agency, but by the Australian Securities and Investments Commission.

ADIs, primarily banks, still account for over 80% of all mortgages commitments in Australia.

Liberty is concerned about what it perceives to be the primary issues leading to mortgage foreclosures in Australian today, namely:

- significant growth in Low Doc lending – most of which (ca 95%) is ultimately approved by APRA- regulated ADIs or mortgage insurers; and
- the current level of unsecured debt and the ease by which consumers can obtain unsecured lifestyle debt, for example personal loans, credit cards and store credit.

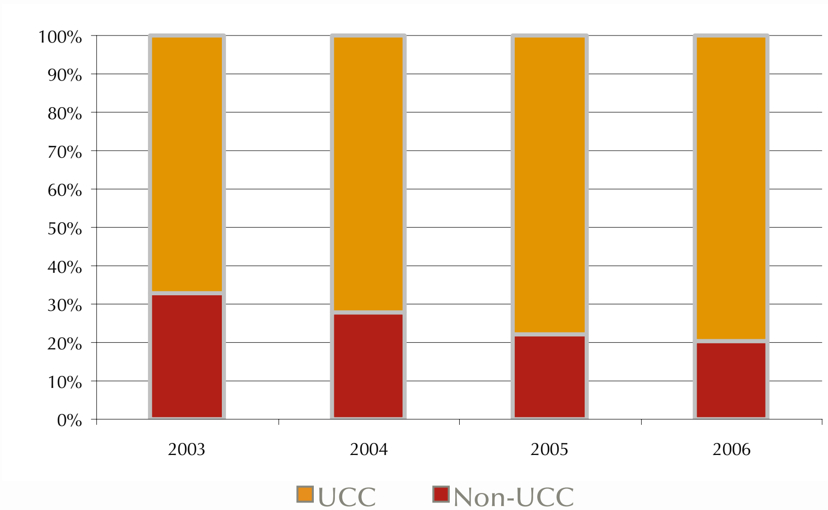
The following slides address the four issues listed for discussion at the roundtable.

Question 1 -

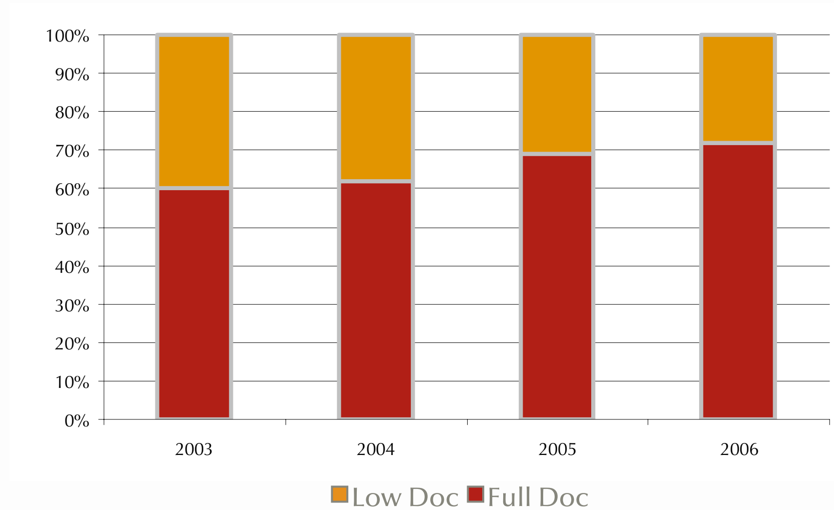
Housing lending credit standards in Australia.

Liberty Financial – a summary of our mortgage portfolio

Australian Mortgages
UCCC and non-UCCC loans



Australian Mortgages
Full Doc and Low Doc UCCC loans

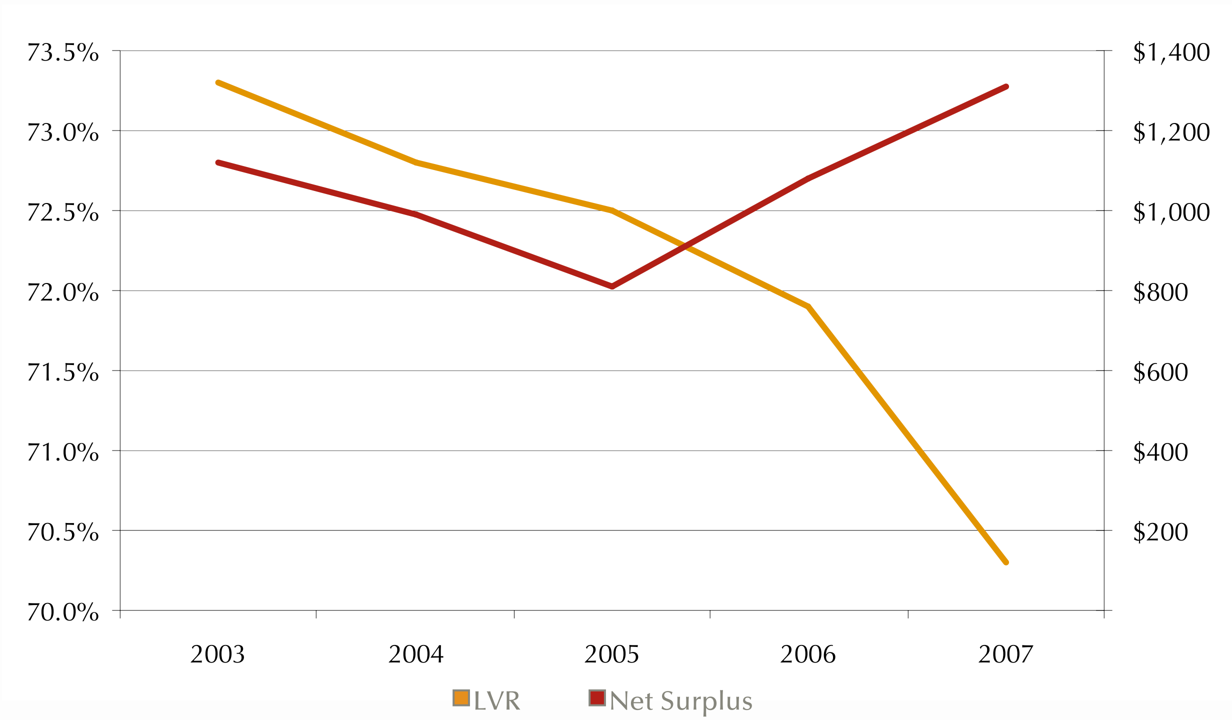


As the Inquiry focuses on the impact of credit standards on consumers, we have interpreted this to be principally consumer loans and have focused the rest of this document exclusively on UCCC regulated mortgages.

Liberty Financial – our credit policy

- We provide alternatives to customers who are not currently being served or who are served poorly by traditional lenders.
- Our core philosophy is providing finance which is of benefit to the customer.
- This means that our approach (in all cases) is to
  1. Verify that customers can afford the credit they are being provided; and
  2. Verify that customers are benefiting from the provision of the credit.
- For example, in all cases we seek to understand and verify the following questions:
  - what is the purpose of the loan?
  - what is the benefit to the client?
  - what circumstances have changed?
  - what circumstances are likely to change?
- Many other specific policies and procedures apply in our business, but this philosophy runs consistently through them all.
- We will not lend money to customers who can ill afford it, or where the credit would not put the customer in a better financial position.

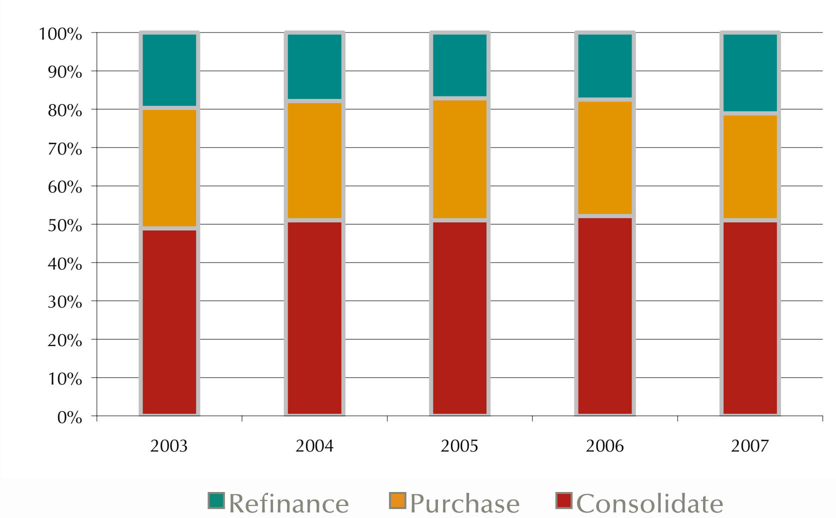
Liberty Financial – UCCC loan serviceability

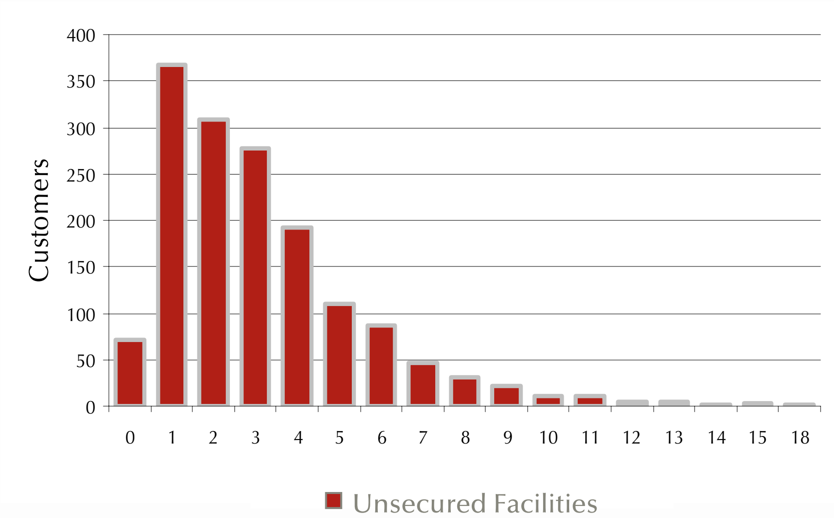


Two measures regularly used to assess a loan's serviceability are LVR and net income surplus. On both measures, an assessment of our loans show average customer positions improving. Specifically LVRs are falling whilst customers' net disposable income surplus is increasing.

Liberty Financial – reasons for taking a loan

- Just over 51% of loans settled since 2003 have been for customers seeking to consolidate debt, often to avoid foreclosures and bankruptcies.
- In all cases of debt consolidation, Liberty insists that the customers' credit cards are cancelled.
- In the six months to June 2007, 44% of loans settled by Liberty were debt consolidations and had average of 3.1 unsecured facilities per loan.
- In 21.4% of cases the customer had 5 or more unsecured debts.





Case Study – impact of unsecured debt

Background

A couple from NSW approached Liberty to assist with a loan to consolidate their debts. At the time they had the following obligations:

Type of Debt	Total Outstanding	Monthly Payment
Mortgage	$ 229,000	$ 1,934
Credit Card 1	$ 23,400	$ 680
Credit Card 2	$ 6,754	$ 190
Credit Card 3	$ 8,028	$ 250
	$ 267,182	**$ 3,054**

Liberty consolidated these debts into a single mortgage totalling $270,000 with a requirement that all credit cards be cancelled. The monthly payment on the new mortgage was $1,814 compared to existing commitments of $3,054.

For a year following settlement the customer made payments in full and on time. Exactly one year into the new loan the customer account went into arrears.

What happened next?

The customer fell behind with payments in May 2006 stating the reason as other expenses (not specified). They were unable to make an arrangement to make up on missed payments at the time and asked for a week to regroup and consider their position. Attempts to contact the customer in the following weeks were unsuccessful. A default notice was issued in July 2006 after numerous attempts to contact the customer by phone. The customer then sought a statement of account – and avoided our attempts at the time to discuss their situation.

In August 2006 the customer advised that they were considering voluntary bankruptcy and property surrender due to excessive debts totalling around $100,000.00. At this stage their mortgage was approximately $5,000 in arrears.

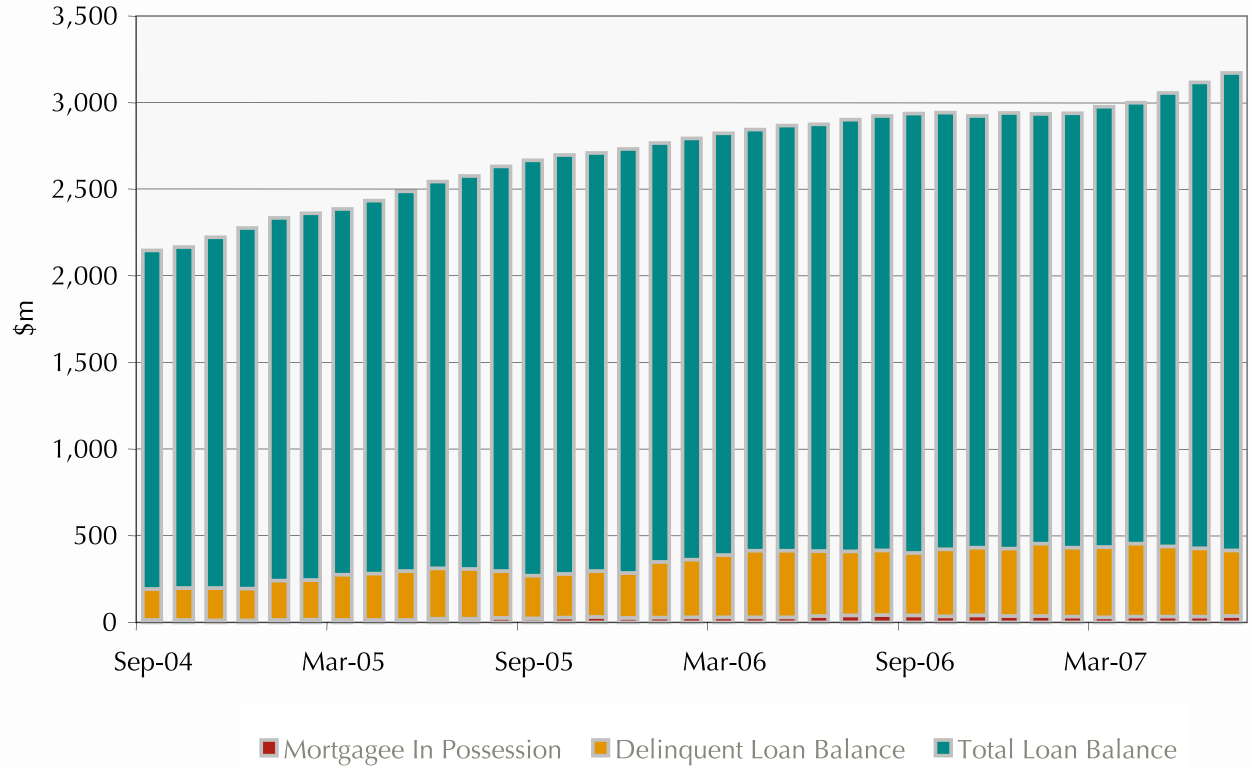
At the end of August, formal documentation was received in regard to their bankruptcy – it showed that the reason for bankruptcy was that the customer had acquired new unsecured credit totalling $113,000.00 since settling their Liberty loan a little over a year earlier. The property was sold with a residual debt of $19K.

Note: some details have been changed to protect privacy of customers

Question 2-

The current level of mortgage defaults and foreclosures.

Liberty Financial – arrears and foreclosures



- Contrary to rising repossession rates, our arrears and foreclosures have remained relatively stable even though our portfolio continues to grow.
- Our customers tell us that credit card debt is a major cause of financial stress for them and the reason most often cited for missing payments.

Question 3-

Treatment of borrowers in financial difficulties.

Liberty Financial - treatment of borrowers in financial difficulties

- Liberty endeavours to treat all customers experiencing financial difficulty with respect and empathy.
- We aim to work with each customer to establish if their situation is a short-term hiccup or an on-going issue.
- Information is then sourced to determine if a loan variation under financial hardship is appropriate. When a financial hardship loan variation is not a viable solution, we work with the customer to reach the best outcome both parties.
- The outcome is different in each case. At Liberty we recognise each customer is unique.
- When an account falls into arrears it is managed by one Loss Mitigation Officer from day one of delinquency until the account is either back in order or until legal action is taken – only as a last resort.
- Our Loss Mitigation Officers work with the customer to establish the root cause of the arrears and to jointly identify a solution.
- All customer contact is recorded in our in-house developed servicing system.
- Options we make available to the customer depending on the individual's circumstances range from a short term arrangement with lower fixed payments, through to interest rate decreases and complete loan restructures.

Case study - treatment of borrowers in financial difficulties

Background

A couple from Victoria took a loan with Liberty Financial in late 2000. The couple made regular repayments on the loan until mid 2004, when payment fell behind a few days. Liberty Financial tried all possible contact numbers in attempts to speak to the customers immediately after they fell behind.

What happened next?

The customer was anxious about establishing contact, but at day 22 of arrears the customer called Liberty and confirmed that Mrs Customer had been made redundant from her job causing the difficulty in making repayments. However, the customer had found new employment and asked to move their regular repayment date to the 15th of each month which Liberty did. The customer and Liberty also agreed to work on paying arrears once the customer better understood their on-going financial position.

The customer had a number of job changes over the following few months, in each case there was good communication and Liberty worked with the customer to make ongoing payment arrangements, so that the customers were up to date in December 2005.

In mid 2006, Mr Customer fell off his truck at work and was unable to work for two months. He was also unable to continue his usual trade and started an office job with less income. In addition, one of Mr & Mrs Customers children incurred a $1,000 telephone bill which required an arrangement to pay.

Following these events and at Liberty's suggestion, the customers provided a statement of position and a variation under hardship was agreed. The customer continues to speak with us frequently and the account is up to date.

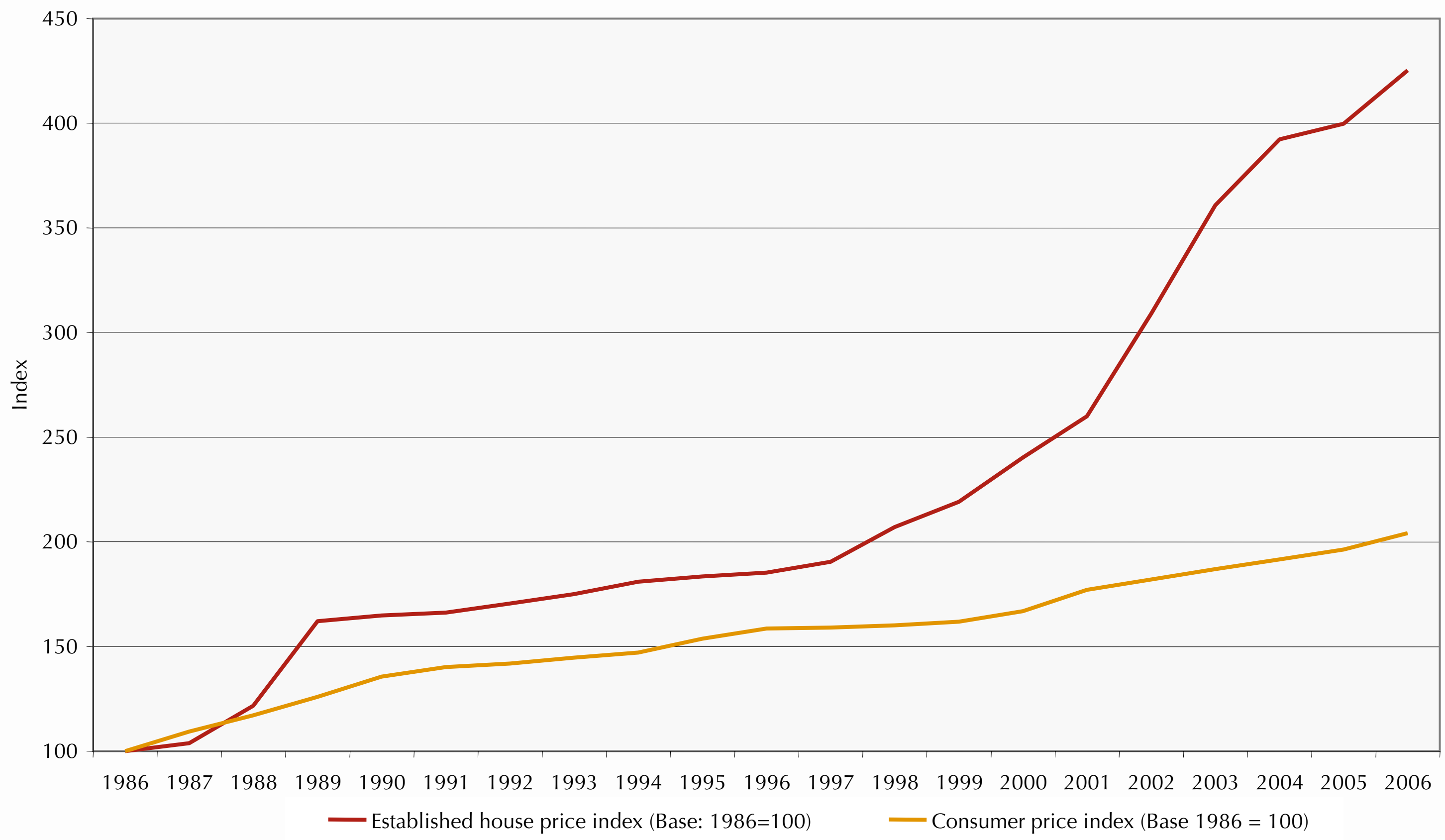
Note: some details have been changed to protect privacy of customers

Question 4-

Potential implications of declining credit standards for the Australian financial system

House Price Growth

Established House Price Index and CPI

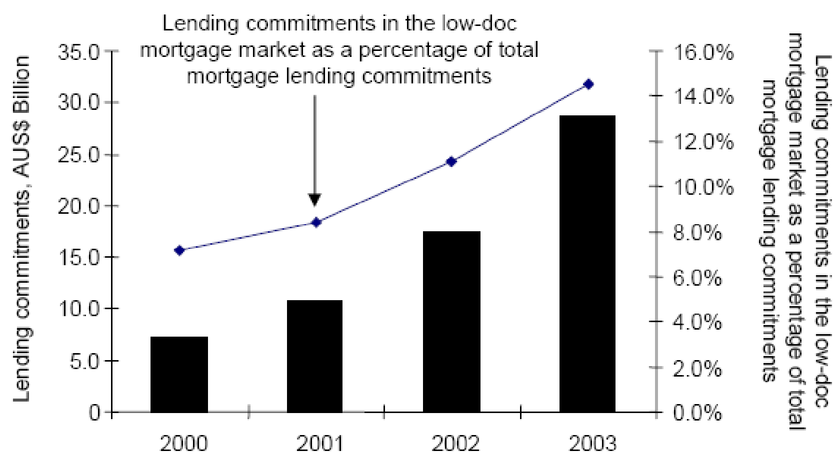


- House prices have accelerated their growth over the rate of inflation.
- Consumers have embraced mortgages in line with these housing price increases.

Source: ABS, REIA, HIA

Growth in Low Doc Lending

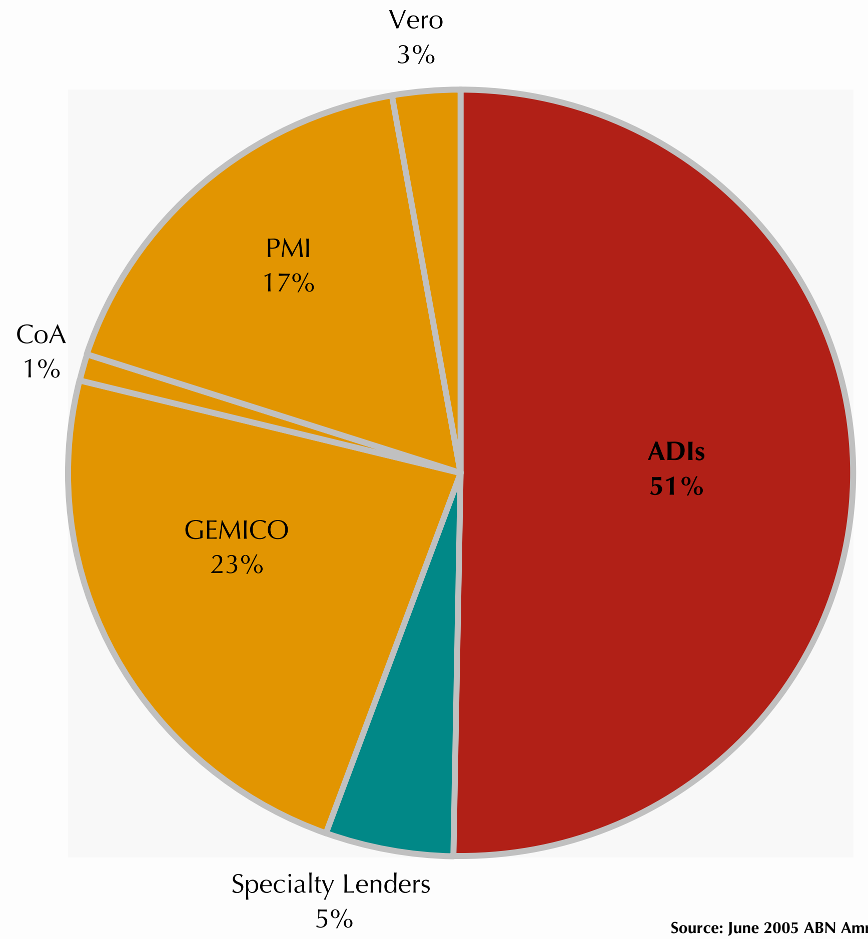
Figure 9: **Lending commitments in the low-doc mortgage market have increased significantly in recent years both in absolute terms and relative to lending commitments in the mortgage market as a whole**



Source: Datamonitor, Australian Bureau of Statistics (ABS), Reserve Bank of Australia (RBA) DATAMONITOR

- Low Doc loans are the fastest growing mortgage debt product with 1 of 7 new commitments.

Low Doc lending exposure - 2005



Key

ADI	Authorised Deposit- taking Institution
GEMICO	GE Mortgage Insurance Corporation Pty Ltd (now Genworth)
CoA	Commonwealth of Australia
PMI	PMI Mortgage Insurance Ltd
Vero	Vero Lenders Mortgage Insurance Ltd

Source: June 2005 ABN Amro estimates, S&P RMBS Performance Watch

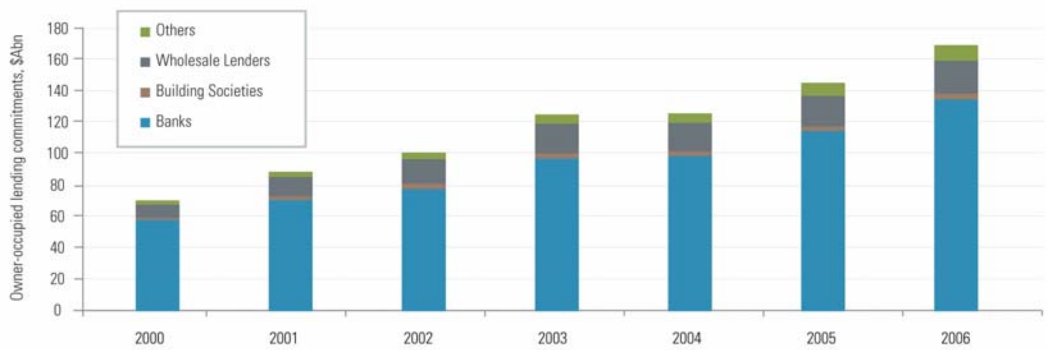
- Over 95% of Low Doc lending is ultimately approved by APRA-regulated ADIs or Mortgage Insurers.

Liberty Financial – our views

- Authorised Deposit-taking Institutions (ADIs) have over 80% of owner occupied lending commitments.
- Around 10% by value of all loans approved in Sept 06 were Low Doc loans.*
- Almost half of the ADIs surveyed by APRA were making Low Doc loans.*
- Specialty lenders have overtime developed strong skills in assessing, managing and pricing for risk. Also they have a vested interest in making the correct assessments, as their loans are not insured.
- Strong property prices act as a buffer against default as financial stress can be managed by selling the property and effectively pre-paying the loan. Should prices fall, as seen in Western Sydney recently, borrower default risk increases.
- In a flattening property market and rising interest rate environment, there could be a correction, with banks being over-represented given their exposure to this market.

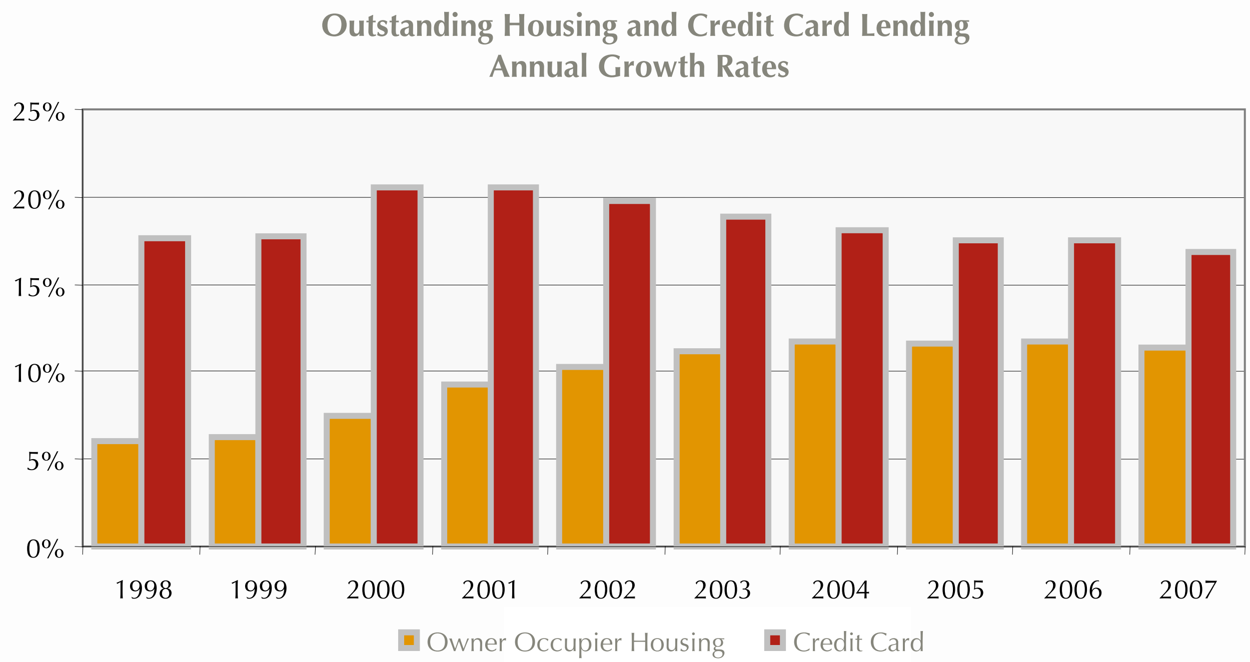
* Source: APRA presentation, June 07

Figure 16: Bank lenders shared almost 80% of owner occupied lending commitments in 2006, their highest share since 2000



Source: Australian Bureau of Statistics

Liberty Financial – unsecured debt growth



- Outstanding credit card debt in Australia is now over $40b. Over the last 10 years it has grown consistently above 15% per annum and sometimes at more than 20% per annum. By contrast, owner occupied mortgage lending has grown at 11.3% (CAGR) over the same period.

Source: RBA and ABS data.

Final observations

In our opinion, it is in the interest of regulators to look at the two key issues that, in our experience, have the greatest impact on both consumers and the financial system at large, namely:

- The level of exposure in Low Doc lending by APRA-regulated ADIs and mortgage insurers; and
- The ease by which consumers can obtain unsecured lending (credit cards, store cards, personal loans and store credit).

Definitions

Below are definitions of the financial terms we have used throughout this presentation.

Arrears – a type of debt which is overdue after missing an expected payment.

Defaults – a failure to pay a debt within the agreed terms and conditions.

Delinquency – loan where the borrower has failed to meet the required payment arrangement – normally measured as up to 30 days, 31-60 or 61 to 90 days.

Foreclosure – legal proceeding in which a secured creditor sells or repossesses a parcel of real property, provided as security, due to the borrower's failure to comply with an agreement between the lender and the borrower.

Low Doc – lending where credit assessment of customer is not supported by validation of all data.

No Doc– lending where credit assessment of customer is not supported by validation of any data.

Non-conforming – sometimes confused with sub-prime market, however, this is a much broader category, including self-employed, people that are employed on a contract/casual basis, etc.

Repossession – see foreclosure.

Specialty finance – provision of a product or service to customers who do not qualify for lenders mortgage insurance.

Sub-prime -- provision of a product or service to customers with credit impairment.

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