Inquiry into Home Loan Lending Practices and Processes

Submission to the House of Representatives Economics Committee

July 2007

INTRODUCTION

Australia and New Zealand Banking Group Limited (ANZ) is pleased to provide a submission to the House of Representatives Economics Committee's Inquiry into Home Loan Lending Practices and Processes.

1. TO WHAT EXTENT HAVE CREDIT STANDARDS DECLINED IN AUSTRALIA IN RECENT YEARS?

ANZ is a responsible credit provider whose underlying principle is to lend only to customers who have been assessed as having the ability to service and repay the approved loan. ANZ has adopted a series of policies to assess a customer's creditworthiness and propensity to make repayments. These include:

- Default cost of living expenses—in assessing a customer's ability to repay, ANZ will take into account the living expenses of the customer. This calculation includes the higher of either default living expenses (based on Australian Bureau of Statistics data) or the customer advised living expenses;

- Servicing margin—ANZ's debt-servicing calculation incorporates an interest rate margin added to the standard variable interest rate to allow for future interest rate increases. This margin ensures that the customer has the ability to meet repayments on the borrowings if interest rates rise. Customers must exhibit a surplus monthly income after cost of living and debt-servicing costs to be eligible for a mortgage loan; and

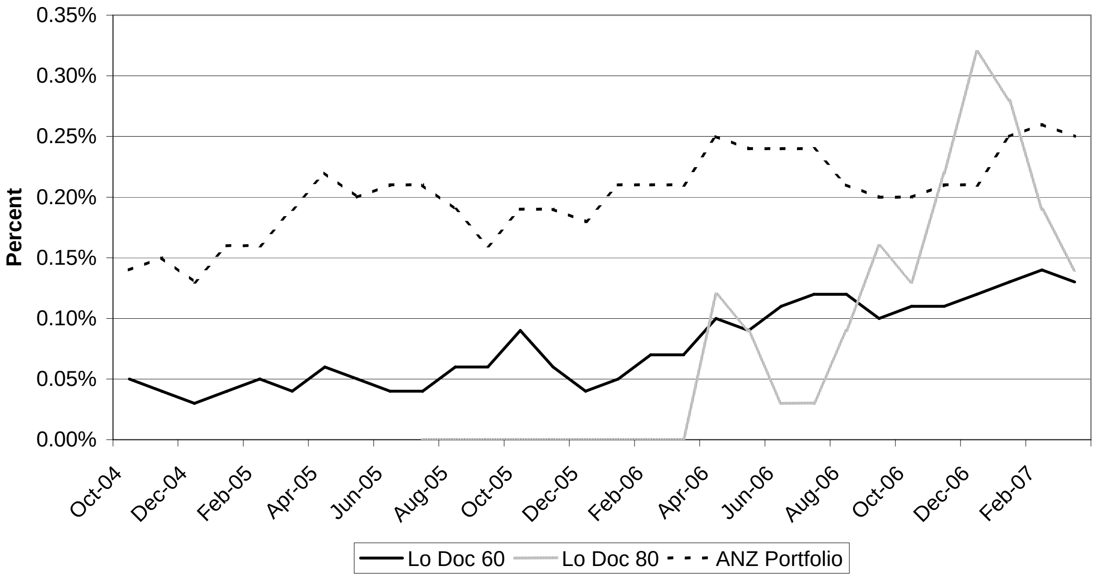
- Application and behaviour scoring—ANZ uses application and behaviour scorecards to assess applicants. Application and behaviour scoring are combined to assess the customer's creditworthiness. This combined score is then compared to ANZ's scorecard to determine if the application will be approved (subject to other policy rules), referred or declined.

The implementation of application and behavioural scoring for mortgages, which began in 1999, resulted in credit standards, in practice, tightening.

ANZ did introduce low documentation lending (Lo Doc) approximately ten years ago and this segment has grown significantly over the period and now represents 18 per cent of the total retail portfolio. ANZ's Lo Doc lending applies to high equity customers, originally those customers with a 60 per cent or lower Loan to Value Ratio (LVR), although ANZ has recently introduced an 80 per cent LVR product which requires mortgage insurance as an additional safeguard.

ANZ's Lo Doc products are aimed at making it simpler for these particular customers, who may not have traditional loan application supporting documentation, to apply for credit. Introduction of Lo Doc loans has been a response to growth in the number of people who are self-employed, work part-time or casually and have a regular income but not the sort of documentation that banks have traditionally required of borrowers to fulfil documentation requirements. The assessment of ANZ's Lo Doc loans is on the same basis as all other home lending (except for the ability to provide external evidence of income) and does not represent any significant change in credit standards. This is demonstrated by the fact that the delinquency rate for these loans is lower than that for ANZ's traditional loan portfolio, and significantly below the delinquency rate for other competitors in the Lo Doc market. This is shown in Chart 1 below.

Chart 1 ANZ Lo Doc Loans and ANZ Loan Portfolio—Loans in Arrears More than 60 Days—October 2004 to March 2007

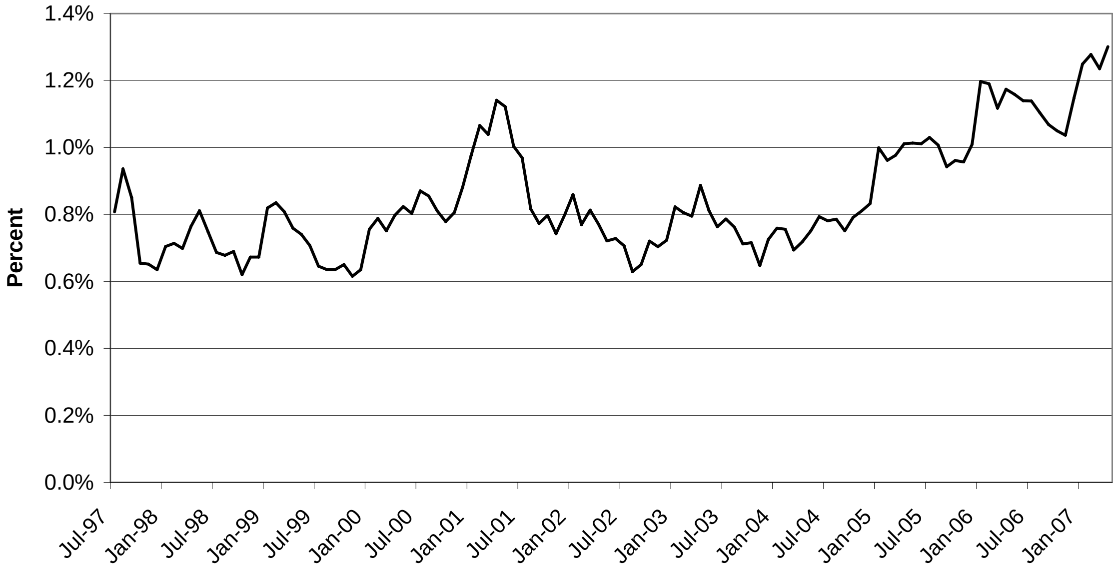


Source: ANZ

2. HAVE DECLINING CREDIT STANDARDS CAUSED AN INCREASE IN THE NUMBER OF LOANS IN ARREARS AND THE NUMBER OF REPOSSESSIONS?

According to the Standard and Poor's performance index (SPIN) total prime residential backed mortgage securities (RMBS) arrears (loans more than 30 days in arrears) has doubled from 0.65 per cent in November 2003 to 1.30 per cent in April 2007 and is now the highest it has been over the last 10 years. This is shown in Chart 2 below.

Chart 2 Australian RMBS Prime SPIN—Loans in Arrears More than 30 Days—July 1997 to April 2007

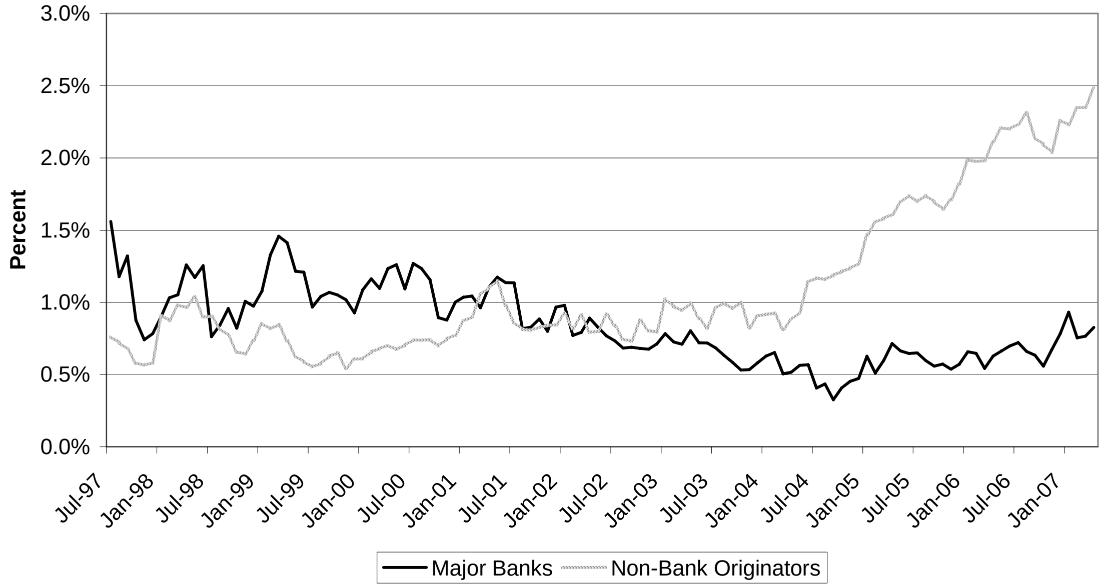


Source: Standard and Poor's RMBS SPIN

However, this increase in arrears has not been seen across the entire financial sector. Looking at the RMBS Prime SPIN for major banks and non-bank originators shows a stark contrast. While the two segments generally tracked together between 1997 and 2003, arrears for non-bank originators then began to increase significantly.

Chart 3 below shows that between November 2003 and April 2007 arrears for non-bank originators more than tripled from 0.82 to 2.48 per cent, while arrears for major banks increased from 0.53 to 0.83 per cent, which is on par with the ten year average of 0.84 per cent.

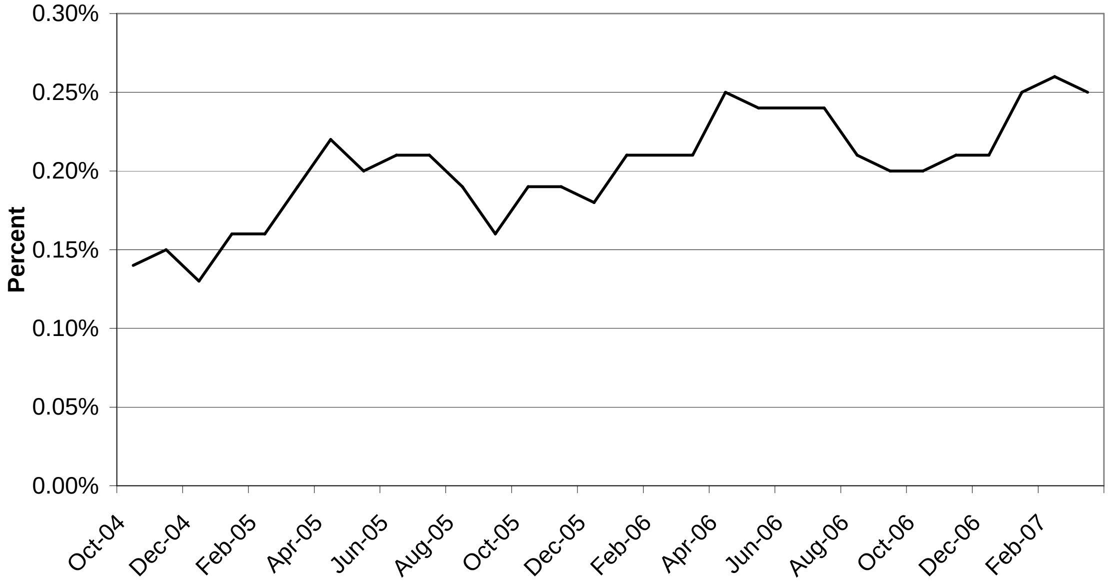
Chart 3 Australian RMBS Prime SPIN—Major Banks and Non-Bank Originators— Loans in Arrears More than 30 Days—July 1997 to April 2007



Source: Standard and Poor's RMBS SPIN

The quality of ANZ's mortgage portfolio is first-rate and this is reflected in its extremely low rate of arrears. Our retail mortgage portfolio loans more than 60 days in arrears have increased from a low of 0.13 per cent in December 2004 to a high of 0.26 per cent in February 2007. This is shown in Chart 4 below. While this increase may appear large in relative terms, this level of arrears is very low by industry and historical standards.

Chart 4 ANZ Mortgage Portfolio—Loans in Arrears More than 60 Days—October 2004 to March 2007



Source: ANZ

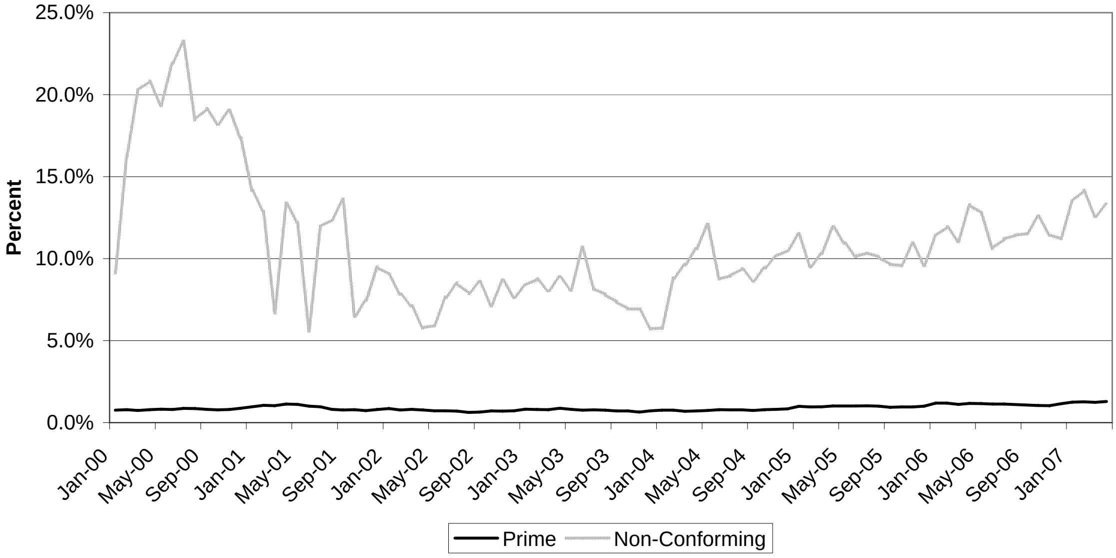
Note: This chart shows loans in arrears more than 60 days, whereas the RMBS SPIN data contained in this section shows loans in arrears more than 30 days. RMBS SPIN data is for securitised mortgages whereas the ANZ data in this chart is for its full portfolio. These differences mean that the results should not be compared.

A market that ANZ does not actively participate in[1], but that has experienced a significant increase in arrears has been the non-conforming[2] market where RMBS SPIN has almost doubled from an already high level of 6.93 per cent in November 2003 to 13.3 per cent in April 2007. This is shown in Chart 5 below.

1 ANZ does not provide specific loans for credit-impaired customers. ANZ is conducting a non-standard security lending pilot which focuses on serviced apartments, a form of non-conforming lending. The customers are prime customers and they are charged a risk premium.

2 Standard and Poor's define the non-conforming market as 'non-prime' however, for the purposes of this submission ANZ has used the term 'non-conforming'

Chart 5 Australian RMBS SPIN—Prime and Non-Conforming—Loans in Arrears More than 30 Days—January 2000 to April 2007[3]



Source: Standard and Poor's RMBS SPIN

Based on Standard and Poor's SPIN data it appears that while arrears have risen in recent years this has been largely driven by the unregulated non-bank originators in the prime market. However, at the same time there appears to be an upward trend in the already high arrears rate for non-conforming lending.

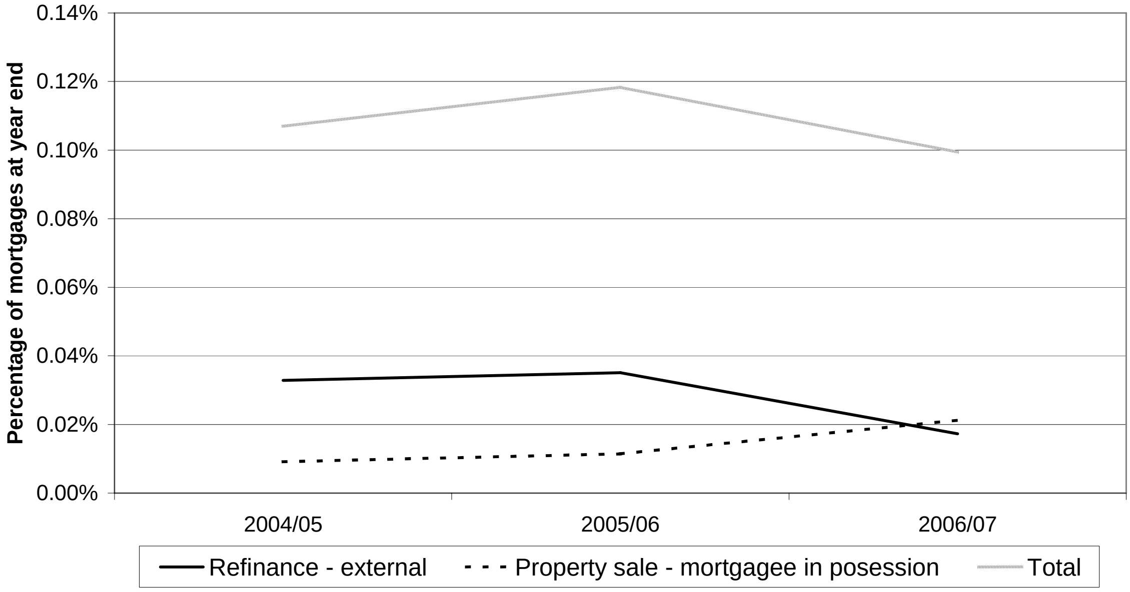
In terms of repossessions a good indicator of ANZ's performance is the number of, and reason for, cases of loans in default finalised by the law firm assigned to manage these once they have exceeded ANZ's internal benchmark.[4] The total number of loans in default finalised by ANZ's law firm as a percentage of the total number of mortgages at year end rose marginally between 2004/05 and 2005/06 from 0.107 to 0.118 per cent, before falling to a low of 0.099 per cent in 2006/07.

There has been an increase in the number of loans in default finalised as a result of sale of property by mortgagee in possession from 0.009 per cent in 2004/05 to 0.021per cent in 2006/07. At the same time there has been a fall in the number of loans in default finalised following the customer refinancing the loan externally, falling from a high of 0.035 per cent in 2005/06 to 0.017 per cent in 2006/07. This is shown in Chart 6 below. Loans in default finalised for other reasons, including customer-initiated sales, generally remained constant over the period.

[3] Further historical data not available

[4] ANZ will refer matters to its law firm after they have become 90 days in arrears, however, in practice matters are typically referred much later than this as ANZ will attempt to come to a repayment arrangement with the customer.

Chart 6 Reasons for Closure of Referred Loans in Default as a Percentage of Total Mortgages—December 2004 Half Year to June 2007 Half Year



Source: ANZ
Note: Some files may relate to a number of properties so the number of sales may be higher

This suggests that while the number of mortgagee in possession sales has risen for ANZ this may be due to a decline in the ability of these customers to refinance with other lenders possibly signifying that credit standards of other market participants have tightened.

3. ARE BORROWERS IN FINANCIAL DIFFICULTY BEING TREATED APPROPRIATELY BY LENDERS?

ANZ complies fully with its obligations under the Uniform Consumer Credit Code (UCCC)[5] and the Code of Banking Practice (CoBP)[6]. In the event that a customer is facing involuntary unemployment, sickness or disability, a reduction in income, an inability to work due to other reasons, a major disaster or other causes of hardship, ANZ can offer a range of options including:

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[5] Section 66 states that "*A debtor who is unable reasonably, because of illness, unemployment or other reasonable cause to meet the debtor's obligations under a credit contract and who reasonably expects to be able to discharge the debtor's obligations if the terms of the contract were changed in a manner set out in Subsection (2) may apply to the credit provider for such a change*".
Subsection 2 allows for the period of the contract to be extended thereby reducing the amount of each payment due, postponing payments on the contract for a set duration, or a combination of both.

[6] Clause 25.2 of the CoBP states "*With your agreement, we will try and help you overcome your financial difficulties with a credit facility you may have with us. We could for example, work with you to develop a repayment plan. If, at the time, the hardship variation provisions of the Uniform Consumer Credit Code could apply to your circumstances, we will inform you about them*".

- Repayment deferrals or extensions;
- Interest only repayments;
- Reduced payment arrangements; and/or
- A reversal of fees incurred during the assistance period.

ANZ was the first Australian bank to introduce a Responsible Lending commitment as a part of its enhanced customer charter, launched in November 2005. As a part of its commitments we are also looking at ways we can reduce financial difficulty among ANZ customers.

One of the key initiatives ANZ has undertaken is to update and improve its existing hardship policy in consultation with Kildonan (financial counsellors). The aim is to reinforce those practices already in place at ANZ, and ensure that they are implemented consistently and in a way that proactively offers the necessary assistance to customers experiencing financial difficulty with fairness and sensitivity.

Areas of focus include:

- Building staff capacity to approach customers proactively and offer assistance in a way that is respectful and sensitive;
- Establishing a definition of hardship that is based on a customer's ability to pay rather than the actual causes of hardship; and
- Taking a customer's word in good faith.

ANZ wants to keep its customers in their homes and it will work with those who are facing financial difficulty to help them achieve this.

4. ARE DECLINING CREDIT STANDARDS LIKELY TO HAVE ANY LONG-TERM IMPLICATIONS FOR THE AUSTRALIAN FINANCIAL SYSTEM?

Growing losses in the US sub-prime market have raised the question of whether we will see a similar situation in Australia. However, there are fundamental differences between the Australian and US markets:

- In Australia, around 3 per cent of the overall mortgage market is non-conforming[7] compared with around 15 per cent of mortgages originated being sub-prime in the US (in 2005 and 2006 this was 20 per cent);

[7] This includes both what the US market calls sub-prime and Alt-A (such a Lo Doc or higher LVR loans)

- The situation in the US reflects the introduction of much higher risk products in the past few years which have been advanced to less credit worthy customers in an environment where house prices and interest rates were rising. The US market has seen the introduction of higher risk products such as:
    - Loans with 40 year terms;
    - 100 per cent plus LVRs; or
    - Loans with a very low start up rate that move up to a higher variable rate.
- According to the Reserve Bank of Australia's March 2007 Financial Stability Review the 90 day arrears rate on securitised non-conforming housing loans in Australia is half the rate on sub-prime loans in the US.

By its higher risk nature, losses in the non-conforming sector will run at a higher level than traditional mortgage lending, but due to the lower size of the sector ANZ does not see conditions for the widespread losses occurring as has happened in the US.

5. CONCLUDING COMMENTS

ANZ has maintained its lending standards and its portfolio continues to perform well in terms of arrears. However, those ANZ customers who do experience financial difficulty will benefit from ANZ's new hardship program, which will ensure that these customers are treated with respect.

ANZ believes that in the event a market failure in the home lending market is identified, it would encourage the Committee to ensure any recommended regulatory measures are directed at the specific segment where the failure exists, and takes into account those initiatives implemented by banks such as ANZ.

ANZ looks forward to building on this submission at the Committee roundtable on Friday, 10 August 2007. ANZ would be pleased to provide any further information about this submission in the interim, and can be contacted as follows:

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