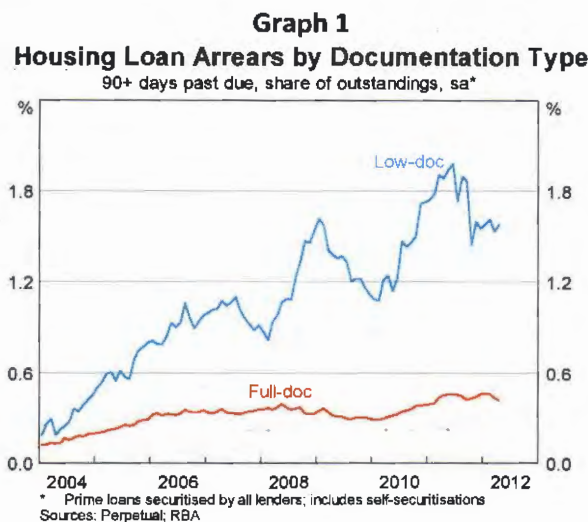
PARLIAMENTARY INQUIRY INTO POST-GFC BANKING SECTOR

Loss experience on low-doc loans (Hansard Ref: p39)

The arrears rate on securitised low-doc loans is currently around 1.6 per cent, compared with 0.4 per cent for full-doc loans (Graph 1). While arrears rates on low-doc loans have historically been higher than for full-doc loans, they do not necessarily translate into higher loss rates. First, the transition from arrears to default is somewhat lower for low-doc loans relative to full-doc loans, as low-doc loans are typically taken out by the self-employed who tend to have more volatile cash flows. That is, volatile cash flows are more likely to cause the low-doc borrower to both enter and leave arrears. Second, lenders generally set lower maximum loan-to-valuation ratios (LVRs) for low-doc loans than for full-doc loans. This means that even though the probability of default is higher, the losses from defaulted low-doc loans are similar to that on full-doc loans (as the lower maximum LVR helps reduce the loss given default).



Low-doc loans currently comprise around 5 per cent of housing loans on banks' balance sheets, and only 1 per cent of banks' housing loan approvals. The decline in low-doc lending over the past few years has been associated with a tightening in credit standards, slower business credit growth (since low-doc loans are designed for the self-employed) and the introduction of the National Consumer Credit Protection (NCCP) laws.

Reverse mortgages (Hansard Ref: p39)

Reverse mortgages involve a homeowner converting existing equity into cash, in the form of a lump sum payment, regular income stream, a line of credit or a combination of these options. Lump sum payments are the most popular option. In contrast to conventional mortgages, reverse mortgage payments flow from the lender to the borrower. Although interest is added to the loan, it does not have to be repaid until the borrower dies or permanently vacates the residence. Industry estimates suggest that, as of December 2011, there was $3.3 billion of reverse mortgages in Australia (Table 1). This compares to a total stock of housing loans of about $1250 billion.

Table 1: Reverse Mortgages

	Loans outstanding ($b)	Loans outstanding (number)	Average loan size ($)
Dec-05	0.9	16,584	51,148
Dec-06	1.5	27,898	54,233
Dec-07	2.0	33,741	60,000
Dec-08	2.5	37,530	66,150
Dec-09	2.7	38,788	69,896
Dec-10	3.0	41,600	72,474
Dec-11	3.3	42,410	78,249

Source: Deloitte

In most reverse mortgages, the lender bears the risk of negative equity. Members of the industry association SEQUAL (Senior Australians Equity Release Association) are required to offer a "No Negative Equity Guarantee" (NNEG). Although the majority of reverse mortgages in Australia are provided by SEQUAL members, there are still some lenders that do not offer a NNEG. In September 2011, the Federal Government introduced amendments to consumer credit protection laws to increase the regulation of reverse mortgages, including making a NNEG compulsory for all reverse mortgages. To reduce the risk of negative equity, the maximum initial loan-to-valuation ratios (LVR) for reverse mortgages are significantly lower than for a normal loan, ranging from 15 per cent for a borrower aged 60, to 45 per cent for someone aged 85. Interest rates on reverse mortgages are higher than for normal loans.

Council of Financial Regulators (CFR) (Hansard Ref: p41)

The CFR was established in 1998 as the successor to the Council of Financial Supervisors (CFS). The CFR's first meeting was in May 1998. Initially, the CFR consisted only of RBA, APRA and ASIC; Treasury joined the CFR in June 2003.