

Chapter 6

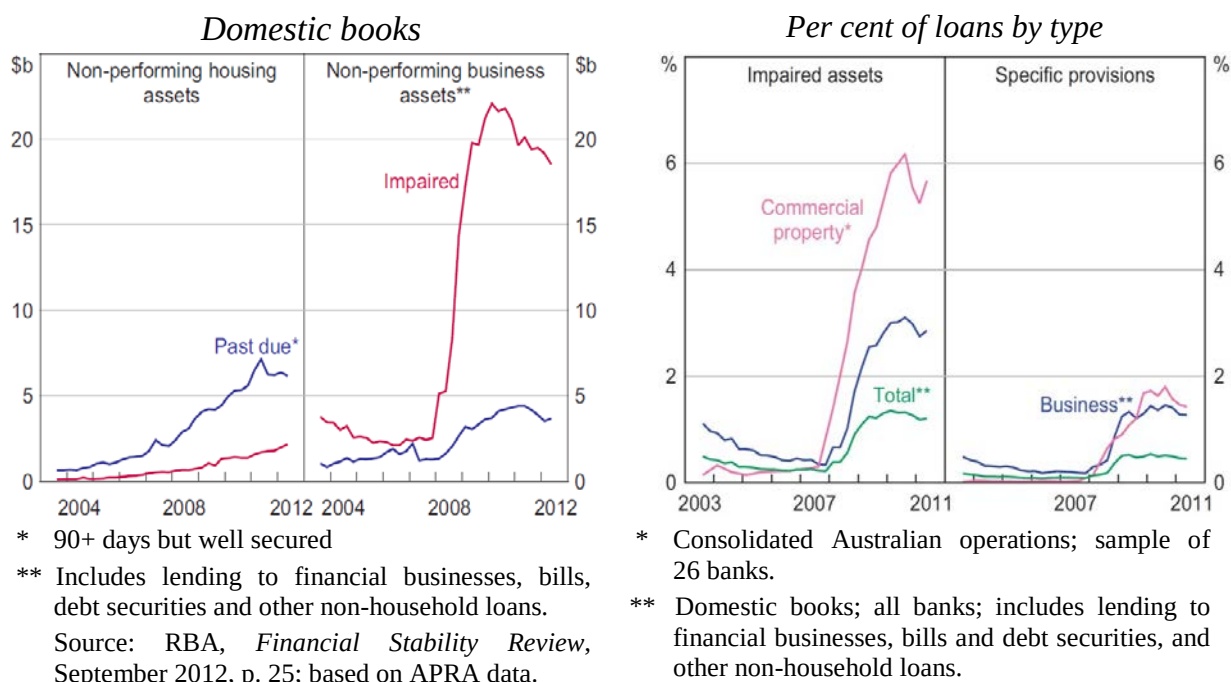
Implications of the crisis on borrowing and lending practices

6.1 The global financial crisis affected the behaviour of businesses and households in a number of ways, but it particularly adjusted attitudes towards risk, credit and levels of debt. Financial institutions also re-evaluated their attitude to risk as it was clearly exposed that risk was under-priced globally in the years leading up to the onset of the crisis in 2007. The subsequent repricing of risk and rising funding costs for banks has impacted both the ability of borrowers to access funds and the attitude that lenders have to certain categories of borrowers. Most submissions to this inquiry have focused on the conduct of Bankwest following its acquisition by the CBA at the height of the global financial crisis in 2008. That matter is examined in the following chapters. This chapter provides an overview of the impact of the crisis on borrowing and lending practices, and examines other issues raised during this inquiry regarding lending practices.

Reaction of financial institutions

6.2 The global financial crisis led to significantly less appetite for credit among households and businesses. Banks generally tightened their lending criteria. On banks' balances sheets, one clear outcome is the heightened level of impairment and non-performance of loans, particularly business loans and those related to commercial property (Figure 6.1).

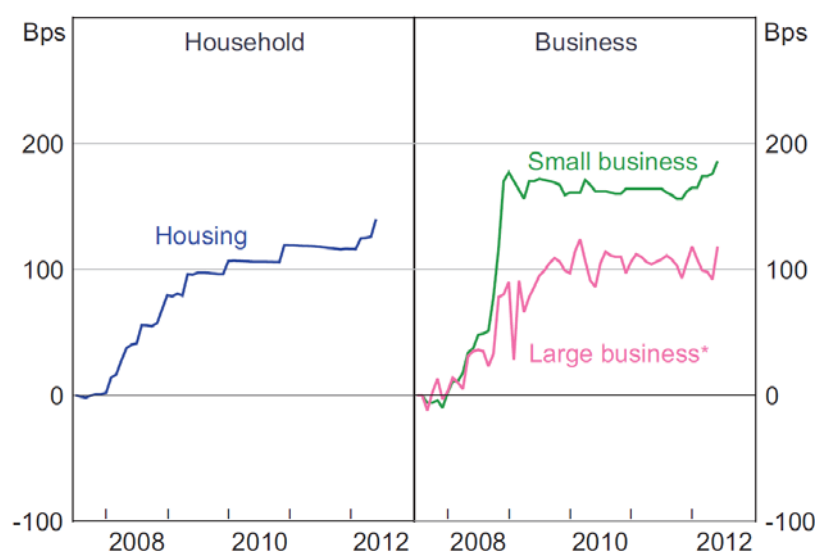
Figure 6.1: Banks' asset quality



6.3 Excessive risk taking and the inadequate pricing of risk were two of the key contributing factors to the global financial crisis. As a result, both wholesale markets and the banks repriced risk. One apparent outcome was an increase in the price of small business loans relative to movements in the cash rate and the interest rate for residential mortgages and large business loans (Figure 6.2). This could simply reflect acknowledgement of the greater risks associated with these loans,¹ although an additional factor could be the developments which impacted competition in the sector, such as Bankwest, which was an aggressive small business lender pre-crisis, being unable to secure funds from its UK parent and being taken over by the CBA in 2008. In any case, as Treasury noted, a noticeable impact on the banks' approach to lending is not surprising:

You cannot have a recalibration of a reassessment of risk without it having the downstream effect of what contains risk for banking institutions—that is, their lending and the way they value the assets which are the collateral for those loans.²

Figure 6.2: Variable lending rates: cumulative change in spreads to the cash rate since June 2007



* Loans greater than \$2 million; includes bill lending.

Source: RBA, *Submission 33*, p. 4; based on ABS, APRA, Perpetual and RBA data.

6.4 While it can be seen that interest rates for small business loans have increased, relative to the cash rate, due to higher funding costs and risk-margins on these loans, how else did banks respond to concerns about risk? The CBA submitted that the

- 1 As noted by NAB's executive director of finance during the Competition Inquiry, business lending has a lower return on equity than housing lending: both 'regulatory assumptions and the loss history models suggest you will have a lot more problems on the business side than on the housing side'. Mr Mark Joiner, Executive Director, Finance, National Australia Bank, *Committee Hansard*, Competition Inquiry, 13 December 2010, p. 54.
- 2 Mr Jim Murphy, Executive Director, Markets Group, Treasury, *Committee Hansard*, 8 August 2012, p. 2.

global financial crisis has not impacted the general criteria against which it assesses loan applications, although since the crisis commenced it has:

- changed the maximum loan-to-valuation ratio for residentially-secured mortgages;
- changed limits for some types of counterparties and credit exposures; and
- applied concentration limits to certain industry sectors.³

6.5 Westpac advised that following the global financial crisis it has not changed its credit standards or lending practices.⁴

Customers' perspectives

6.6 Compared to pre-crisis levels, consumers have reduced their debt and changed their attitude to debt. ANZ advised that almost half of its variable rate mortgage customers are ahead of their repayment schedule, which its Deputy CEO described as a 'very unusual number'.⁵ ING Direct advised that in its case over half of its customers are ahead of the monthly repayment schedule, and that this proportion is increasing.⁶

6.7 The number of disputes with financial institutions escalated to an external dispute resolution process has grown. Information provided by the Financial Ombudsman Service (FOS), an external dispute mechanism for the banking sector, shows that it received 30,283 disputes in 2010–11 including around 14,500 disputes about credit. FOS noted that there has been a sharp increase in disputes about financial difficulty in recent years, mainly about consumer credit products. These disputes have increased from around 2,640 in 2009–10 to over 6,100 in 2010–11.⁷ Of the disputes resolved in 2010–11, the most common outcome was by agreement between the parties (18,388 matters), with FOS being required to make a decision in just over 3,000 matters.⁸

3 Commonwealth Bank of Australia, *Submission 81*, p. 32.

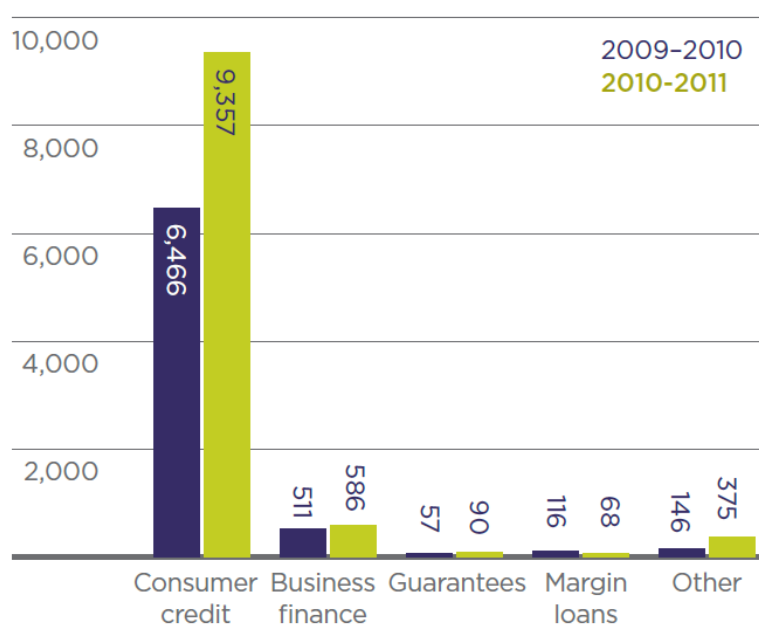
4 Mr Jim Tate, Acting Chief Operating Officer, Australian Financial Services, Westpac Group, *Committee Hansard*, 9 August 2012, p. 1.

5 Mr Graham Hodges, Deputy Chief Executive Officer, ANZ Banking Group, *Committee Hansard*, 9 August 2012, p. 16.

6 Mr Bart Hellemans, Chief Risk Officer; Mr Glenn Baker, Chief Financial Officer, ING Bank (Australia) Ltd, *Committee Hansard*, 10 August 2012, p. 37.

7 FOS, *Submission 50*, p. 3.

8 FOS, *2010–2011 Annual Review*, p. 23. Thirty-eight per cent of these decisions were in favour of the applicant.

Figure 6.3: Credit disputes accepted by FOS by product category

Source: FOS, *2010–2011 Annual Review*, p. 33.

6.8 There are a number of factors which, in FOS's view, led to the increased number of disputes in 2010–11. The global financial crisis is one factor to which the increase is attributed. Other factors include the increases in interest rates in 2009–10, the commencement of the *National Consumer Credit Protection Act 2009* (NCCP Act), the expansion of FOS's jurisdiction at the start of 2010, increased awareness of FOS and a lack of confidence among consumers in financial institutions' dispute resolution processes.⁹

6.9 The committee also received information specifically relating to small business finance. CPA Australia provided the results of roundtable discussions it conducted in late 2011 and early 2012. CPA Australia's report noted various improvements compared to its 2009–10 study, including increasing access to finance over the past three years, however it concluded:

The SME lending landscape has not changed dramatically since CPA Australia's previous work on the topic in 2009–10. The key theme at that time was that SMEs were subject to tightened lending conditions they were not prepared for, and that the difficulty in accessing finance had impacted business operations and performance. The other important issue was the demise in the relationships between banks and SMEs.¹⁰

9 FOS, *Submission 50*, p. 5.

10 CPA Australia, *Submission 51*, attachment A: *SME access to finance: recent experiences of SMEs in accessing finance*, May 2012, p. 3.

Predatory lending and incentives for bank employees

6.10 Some unease about the direction in which certain aspects of consumer lending in Australia was headed pre-crisis was expressed, although it was noted that recent changes to consumer credit legislation may address some of the identified issues:

In the case of, for example, predatory lending, not being privy to the details of individual loan contracts, it is clear that our banking system was moving towards the situation of excessively high loan-to-valuation ratios and various lending practices that were perhaps not in the best interests of customers. But we had not got anywhere near I think the situation of other countries, and here we have had legislation about know your customer and more emphasis on banks being able to assess the suitability of loans.¹¹

6.11 In the ABA's view:

We are not pure, but also I do not think we have a systemic problem with predatory lending. It is not actually in the banks' interest to lend money to people who cannot repay it.¹²

6.12 The ABA was also questioned about the incentive structures for lending. Its CEO, Mr Steven Münchenberg, noted that bank employees may be incentivised to sell certain products as part of their remuneration, and acknowledged that 'we need to be very careful about that', but he did not consider bank employees are incentivised to take risks.¹³ When questioned about attitudes to risk in the banking sector more generally—specifically whether financial sector employees systematically underestimate risk and whether investors don't understanding the risk of leverage and underestimate its consequences—Mr Münchenberg contended that if this was a phenomenon in Australia 'we would have absolutely found out in the last few years':

Our banking system in Australia and banking systems worldwide have been through the most robust and thorough stress testing over the last few years you could possibly imagine. Many of those systems and many of those banks have fallen short. Ours has not ... it was not through accident that our banking system did as well as it did; it was through careful management of risk in Australia and very good regulation and supervision—all of which was in place before the GFC. Should we look at improving on that? Absolutely, and we have been over the last couple of years. The government has introduced a whole range of measures and a whole range of measures are coming from offshore.¹⁴

11 Professor Kevin Davis, Australian Centre for Financial Studies, *Committee Hansard*, 8 August 2012, p. 40.

12 Mr Steven Münchenberg, Chief Executive Officer, Australian Bankers' Association, *Committee Hansard*, 8 August 2012, p. 23.

13 Mr Steven Münchenberg, *Committee Hansard*, 8 August 2012, p. 24.

14 Mr Steven Münchenberg, *Committee Hansard*, 8 August 2012, p. 24.

6.13 The discussion shifted from the abstract to the specific when representatives of the major banks gave evidence. Examples of low-doc loans and reverse mortgages were raised with Westpac, where a bank manager signed up elderly clients to long-term mortgages, and encouraged them to invest in a developing company:

Senator WILLIAMS: ... I will give you an example. Mrs Heather Simmers, who is now 101 years old, was signed up personally by your bank manager for a 30-year mortgage, for \$440,000, at the Clem Jones nursing home in Brisbane ... according to this lady who worked for the company, 'as witnessed by me and her daughter, Mrs Del Black, approximately 70 years old, who had a similar Rocket loan. Both mother and daughter are aged pensioners with no other income. I was ordered by Tony and Brad Silver to drive the bank manager to that location. I picked him up at Oxenford that day and also saw the vehicle which he had been awarded for his valuable contributions to the company, CGIC Pty Ltd. This was [a] white Mazda CX-9 vehicle, a 2010 model worth about \$50,000. This gift was confirmed by Tony Silver, who stated that a sale was concocted again, according to Silver, to protect the bank manager from any consequences from accepting such items.' Well, this company went broke. This lady is now 101 years old.

Mr Tate: The bank manager got a Mazda?

Senator WILLIAMS: Yes.

Mr Tate: Who did he get it from?

Senator WILLIAMS: From the company that he was telling all his clients to invest in. I think this is a police matter.

Mr Tate: It certainly sounds like it.¹⁵

6.14 A Westpac executive later stated 'it was an outright fraud, there is no question about that. Obviously the bank will be disgusted about it, and we would want to take action directly against the person involved, if it has not already been taken'.¹⁶ The Westpac executive also committed to look into and address this matter:

Senator WILLIAMS: ... I am deeply concerned about this, and I ask you to address it. If what this lady says is correct—and I have no reason whatsoever to doubt her truth; she has just recently recovered from a brain tumour operation—then I think this should be righted, Mr Tate.

Mr Tate: You have my assurance that that will be the case. It is unconscionable; I am not going to defend it. The reason I asked about WA is that there was a firm of brokers in WA that similarly engaged in a range of fraudulent activity, and we made restitution to the people affected by that. Using the same principle, I have no drama in taking that on.¹⁷

15 Mr Jim Tate, Acting Chief Operating Officer, Australian Financial Services, Westpac Group, *Committee Hansard*, 9 August 2012, pp. 5–6.

16 Mr Jim Tate, Westpac Group, *Committee Hansard*, 9 August 2012, p. 6.

17 Mr Jim Tate, Westpac Group, *Committee Hansard*, 9 August 2012, p. 7.

6.15 A senior APRA official pointed out that there are a large number of employees in the Australian financial services sector, and that they obviously deal with a lot of money. However, he noted that from APRA's perspective, any nefarious practices appear isolated and are not affecting the stability of the sector:

Mr Littrell: Neither we nor anyone else is going to be able to say there will never be misbehaviour in the financial services industry by the providers or the customers. We can say to you that in terms of our role, which is ensuring the institutions are financially sound, we do have systems in place to give us good feedback about whether there is a substantial or systemic problem. For example—again, pulling a number somewhat out of the air—let us say there are three million home loans and over 99 per cent of them were being paid back without, apparently, much difficulty.

Senator CAMERON: A lot of mortgage holders would say that is not true. Lots of them have difficulty.

Mr Littrell: Difficulty in the sense of collection, not in the sense of payment. From the point of view of the prudential regulator, some of those loans were made in error but not enough to threaten the solvency of the institutions—not even close. We could run similar sorts of things on credit cards or small business loans.¹⁸

6.16 Another APRA official made the point that the issues raised appear to be instances of fraud that should be investigated by the police, rather than being a matter of prudential regulation.¹⁹ The committee has not been advised by APRA as to whether or not it has referred any such instances to police for investigation.

Low-doc loans, allegations of fraud and implications for the AOFM program

6.17 During the course of this inquiry, specific issues regarding low-doc loans were raised. It should be noted that most of the issues raised are, strictly speaking, beyond the scope of this inquiry given that this is an inquiry into developments arising out of the global financial crisis and some of the specific issues raised relate to the pre-crisis period. However, as the allegations were raised in evidence, and further claims were made regarding how the AOFM's post-crisis securitisation program may be impacted—an issue relevant to this inquiry—these matters are discussed in this section. Recent media reports that suggest certain lenders are enthusiastically offering low-doc loans with high LVRs also makes the general topic of low-doc loans relevant.²⁰

6.18 Low-doc loans are loans that require less financial documentation—such as proof of employment and income—than standard loans. They are intended for

18 Mr Charles Littrell, Executive General Manager, Policy, Research and Statistics Division, APRA, *Committee Hansard*, 9 August 2012, p. 56.

19 Mr Keith Chapman, Executive General Manager, Diversified Institutions Division, APRA, *Committee Hansard*, 9 August 2012, p. 55.

20 Anthony Klan, 'Low doc risks rise in loans scramble', *The Australian*, 26 September 2012, p. 3.

borrowers that find it difficult to demonstrate their capacity to repay, such as the self-employed. The Banking and Finance Consumers Support Association, headed by Ms Denise Brailey, alleged that there is the potential for a significant amount of loan application fraud and lending maladministration for low-doc loans. Of serious concern to the committee were Ms Brailey's alarming allegations of widespread fraud related to the loan applications, based on additional pages to the application forms being filled out by a person other than the borrower with exaggerated statements made about the borrower's income. Ms Brailey was asked about the application forms at a public hearing:

Senator WILLIAMS: Let us just go through the application form. Normally an application form is three pages.

Ms Brailey: The banks have told us they were three pages. The banks gave the courts documents to say the loan application form was three pages. They were not; they were an 11-page document—always.

Senator WILLIAMS: So when the customer signed off the loan application form, the customer signed three pages not 11?

Ms Brailey: Three pages, that is right.

Senator WILLIAMS: You are saying that after the customer signed those application forms, figures were altered on the 11-page form?

Ms Brailey: Yes. The way it worked was that the other pages of the application—and I have this complete one here—were inserted and that would be faxed through to the bank. The people would never see the rest of the document.²¹

6.19 The individuals affected by these allegations are generally asset-rich, income-poor individuals (such as pensioners or low-income families) who were encouraged to take out large loans to make investments intended to increase their income. However, they did not have the financial capacity to repay the loans and this led to hardship when the investments went bad. The use of 'ABNs for a day' was also discussed, where lenders allegedly urged brokers to apply for an ABN for their clients to indicate that they were self-employed.

6.20 The regulation of low-doc lending has changed in recent years. The NCCP Act, which commenced on 1 July 2010, introduced a national framework for the regulation of consumer credit, which included a responsible lending obligation on lenders. This obligation requires lenders and mortgage brokers to make reasonable inquiries into and verify a potential borrower's financial situation to assess whether the credit contract is not unsuitable for the borrower's requirements, and that the borrower has the capacity to comply with the contract's financial obligations without substantial hardship. Evidence taken by the committee indicates that the responsible lending obligation is having an impact. A Westpac executive advised that low-doc lending

21 Ms Denise Brailey, President, Banking and Finance Consumers Support Association, *Committee Hansard*, 8 August 2012, p. 47.

represented around two per cent of its new loans at the moment, down from around ten per cent before the NCCP Act.²² The Westpac representative also commented that, as a result of lenders being required to make reasonable inquiries regarding income, it has transpired that self-employed borrowers do have 'quite a substantial amount of documentation', such as business activity statements and other accounting information.²³ Information provided by the RBA supported Westpac's evidence:

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.²⁴

6.21 ASIC stated that it had taken enforcement action regarding low-doc loans over a number of years²⁵ and that it has been active in regulating low-doc loans since the NCCP Act commenced, noting that it undertook a review of low-doc loans within the first six months of obtaining responsibility under the NCCP Act for these lending practices.²⁶ It noted some areas for improvement among brokers, but that:

ASIC saw improvement, continues to see improvement and is monitoring things. ASIC has followed up individual cases where it felt that the conduct fell short. It continues to be a focus for ASIC given the risks in the market are probably most acute in the market that promotes low-doc lending.²⁷

6.22 Recently, ASIC also was successful in the first criminal charges brought by it under the NCCP Act when a former mortgage broker pleaded guilty to ten offences including providing false documents to banks and assisting clients to apply for loans that were unsuitable for them.²⁸

6.23 On the specific claims raised by Ms Brailey, ASIC advised that it 'has not identified widespread evidence of systemic misconduct in the banking sector along the lines suggested':

In response to previous general allegations made by Ms Brailey ASIC has requested her on a number of occasions to provide ASIC with any

22 Mr Jim Tate, Westpac Group, *Committee Hansard*, 9 August 2012, p. 7.

23 Mr Jim Tate, Westpac Group, *Committee Hansard*, 9 August 2012, p. 5.

24 RBA, answer to question on notice, 9 August 2012 (received 20 August 2012), p. 1.

25 For examples of this enforcement action, see ASIC, answer to question on notice, 8 August 2012 (received 20 September 2012), pp. 4–6.

26 See ASIC, *Report 262: Review of credit assistance providers' responsible lending conduct, focusing on 'low doc' home loans*, November 2011.

27 Mr Michael Saadat, Senior Manager, Deposit Takers and Issuers, ASIC, *Committee Hansard*, 8 August 2012, p. 54.

28 ASIC, 'Former mortgage broker pleads guilty to first charges laid under the National Credit Act', *Media release*, no. 12-237, 25 September 2012.

additional information and specific evidence of falsification of documents in the banking sector. This evidence has not been forthcoming. Following her testimony to the Committee, ASIC has again requested Ms Brailey to provide any such evidence.

More recently, ASIC has received a number of letters from members of Ms Brailey's Banking and Finance Consumers Support Association, Inc (BFCSA), some of which raise general concerns about low-doc loans and call for a Royal Commission, and others which raise concerns about their own loan transactions. However, these letters generally make broad allegations of misconduct and do not contain any specific evidence of the alleged misconduct. We are therefore encouraging these people to provide us with additional information and documents to assist us in assessing the matters.

We also understand that a number of BFCSA's members obtained loans from finance broker Mortgage Miracles. The Western Australian Police has charged Mortgage Miracles' director, Ms Kate Thompson, with fraud offences in relation to her conduct as a mortgage broker and it is understood that a hearing on whether Ms Thompson is fit to stand trial is scheduled to be held on 12 November 2012.²⁹

6.24 In response to ASIC's testimony, Ms Brailey wrote to the committee where she vehemently denied ASIC's allegations:

ASIC wants the Senators to believe it only has 17 cases of imprudent lending to deal with regarding the Low Doc Scandal ... ASIC suggests it investigates every case. It certainly does not. Such assertions are false.

* * *

ASIC is clearly telling the Parliament it's the Brokers providing incorrect figures and we have been constantly advising ASIC it is the ADI's to blame not the brokers. My files prove the above assertion by ASIC is plainly false. ASIC answered all 300 letters by suggesting they fell under the 1 July 2010 criteria that ASIC has set to rid its files of all the complaints stockpiled 2005–2010.

My files are full of ASIC letters of refusal to investigate claims, acquired since 1998.

Once again ASIC has told the Inquiry under Oath it sees "no systemic issues" ... I am continually reminding ASIC it is their job to investigate complaints, not mine.³⁰

29 ASIC, answer to question on notice, 8 August 2012 (received 20 September 2012), p. 7.

30 Ms Denise Brailey, correspondence to the committee dated 9 October 2012, p. 5 (emphasis omitted).

6.25 The committee is concerned about the obvious discrepancies between ASIC's claims and Ms Brailey's claims and believes it warrants further investigation.

6.26 The Australian Securitisation Forum (ASF) forcefully disputed the claims made by Ms Brailey. In the ASF's view, 'these assertions lack credibility based on the absence of significant defaults arising from such loans'. It argued that any loans entered into prior to 2008 would now have been in existence for more than four years and that issues with delinquency would be clear by now:

For loans included in securitisations, performance issues relating to a borrower's inability to service the loans would now be evident through the monthly reporting of arrears and defaults that is provided to investors in RMBS issues. As a general statement, fraudulently originated loans typically exhibit early term delinquency, usually within the first six months of their life. There is no evidence of the occurrence of systemic fraud in relation to low-doc lending despite the product being generally available for in excess of a decade, aside from the allegations that have now surfaced.

S&P produces a quarterly report of the performance of all pools of securitised residential mortgages, both full and low-doc. The most recent S&P report for the quarter ending 31 March 2012 indicates only 3.28% of low-doc loans are 90+ days in arrears. This is a small percentage of all low-doc loans. To put this into perspective, low-doc loans that are 90+ days in arrears represent only around 0.2% of the total residential mortgage loans in the financial system. It is also noteworthy that the loss rates on residential mortgages in Australian RMBS before claims under mortgage insurance are less than 0.22% and there has been zero historical losses or charge-offs against any Australian Issued prime RMBS.³¹

Possible impact on the AOFM securitisation program

6.27 The possible implications of widespread loan application fraud for the AOFM's securitisation program were also raised. As noted in chapter 4, the Australian government started to support the securitisation market during the global financial crisis by instructing the AOFM to temporarily invest in AAA-rated Australian RMBS. Ms Brailey argued that the securities purchased by the AOFM would be affected by the fraudulent conduct she alleged has taken place. Ms Brailey is of the view that:

... the government is holding tainted securities and profiting from that fraud. We believe there is about \$57 billion involved. And, judging by the average loans, which go above FOS's jurisdiction—we are talking about maybe 100,000 families affected—a government cannot, or at least cannot be seen to be profiting from that fraud of its constituents and must rectify that situation.³²

31 Australian Securitisation Forum, *Submission 153A*, p. 3.

32 Ms Denise Brailey, *Committee Hansard*, 8 August 2012, p. 44.

6.28 AOFM officers were questioned by the committee about the allegations. The CEO of the AOFM stated that:

We are aware through the media and this inquiry that allegations have been made regarding fraudulently originated mortgages, although we have not seen or heard of any evidence of this in connection with the mortgages underpinning AOFM's RMBS portfolio.³³

6.29 AOFM officers advised the committee that it takes a number of measures to address risk associated with RMBS. There is the overriding requirement contained in the Treasurer's directions that the securities be AAA-rated. The size of the LVRs and whether the loans have lenders' mortgage insurance are also considered. The AOFM requires the pools of mortgages backing the RMBSs it invests in to have an LVR of 95 per cent, unless the pool consists of more than ten per cent low-doc loans, in which case the AOFM requires an LVR of 80 per cent and that the loans be covered by lenders' mortgage insurance (although they noted there has only been one case of this).³⁴ The officers noted that lenders' mortgage insurance covers the vast majority of pools, with the weighted average coverage rate being around 98 per cent across the AOFM's RMBS portfolio.³⁵ Other measures that provide some protection for the AOFM's investments include:

- a risk-based due diligence program;
- 'pool' and 'tie back' audits;³⁶ and
- the tranching of investments.³⁷

6.30 The AOFM representatives advised that at 31 July 2012, the 30+ days arrears for the AOFM portfolio was 1.1 per cent (they observed that this is below the 1.5 per cent 30+ day arrears rate for all prime pools reported by Standard & Poor's in June

33 Mr Robert Nicholl, Chief Executive Officer, AOFM, *Committee Hansard*, 21 September 2012, p. 2.

34 Mr Robert Nicholl, Chief Executive Officer; Mr Michael Bath, Director, Financial Risk, AOFM, *Committee Hansard*, 21 September 2012, pp. 1, 4.

35 Mr Robert Nicholl, AOFM, *Committee Hansard*, 21 September 2012, p. 2.

36 These independent audits seek to confirm the conformance of the pool with the AOFM's minimum edibility requirements (pool audit) and that a representative sample of mortgages in the pool can be traced back to loan documentation (tie-back audit). See AOFM, 'Purchase of RMBS – Program update', no. 2, 2011 (8 April), www.aofm.gov.au/content/notices/02_2011.asp (accessed 26 September 2012).

37 As the AOFM invests in AAA-rated securities, these typically are also senior or mezzanine tranches that are repaid before subordinated tranches. The CEO of the AOFM stated that 'this means that the owners of more heavily subordinated, or 'first loss' tranches, provide additional protection to the AOFM's interests'. Mr Robert Nicholl, AOFM, *Committee Hansard*, 21 September 2012, p. 2.

2012).³⁸ On a hypothetical basis, the CEO of the AOFM entertained the consequences of fraudulently originated mortgages. He advised that less than two per cent of the AOFM's investments are linked to low-doc loans.³⁹ He argued that because of the ranking of tranches, however, the maximum loss for the AOFM in an extreme scenario would be around half a per cent of its total investment. The CEO added:

Finally, because the AOFM only invests in RMBS that contain mortgages that have already been originated, it has neither involvement in nor control over how the practice of mortgage lending is undertaken. This is clearly a matter for the financial industry to organise, practise and monitor. Furthermore, it would simply not be practical or reasonable for the AOFM to employ the substantial resources required to vet the detail of every mortgage behind every RMBS transaction which it has been or may be asked to support. We estimate that there are over 129,000 mortgages that underpin the RMBS transactions that we have been asked to analyse and support, and, of this total, about 2,000 would have been low-doc loans.⁴⁰

Committee view

6.31 The committee is concerned that there has been a consistent abuse of low-doc loan facilities, albeit in a small percentage of total low-doc loans issued. The responsible lending requirements contained in the credit reforms that commenced in 2010 appear, at this time, to be effective in placing much greater obligation on lenders and brokers to verify income and the borrower's capacity to repay a loan. It should be recognised that there is a role for low-doc loans in the marketplace to meet the needs of self-employed workers who would struggle to obtain finance otherwise. There are, however, greater risks for lenders and potentially for the financial system as a whole if this type of lending activity is not carried out responsibly. The committee considers that ASIC should very closely scrutinise developments relating to these products, particularly if demand for credit becomes less subdued.

6.32 The committee notes the allegations regarding a number of possible cases of fraud that occurred pre-crisis. As a result of this inquiry, ASIC has publicly called for *detailed* evidence regarding these claims to be provided to it. The committee is similarly aware that many organisations and individuals, most notably Ms Denise Brailey, feel as though their complaints to ASIC have been met with a singular lack of cooperation. The committee is of the view that ASIC, upon receipt of allegations that present an arguable case, should undertake its own investigations to establish whether a *prima facie* case of fraud exists. Evidence of fraudulent lending practices can also be dealt with by the police. While the committee acknowledges that this is not without its

38 Mr Robert Nicholl, AOFM, *Committee Hansard*, 21 September 2012, pp. 1, 2. The Standard & Poor's figures consisted of 1.26 per cent for prime full-doc loans and 6.07 per cent for prime low-doc loans.

39 \$400 million out of the \$25 billion in mortgages backing the AOFM's investments are low-doc loans. See Mr Robert Nicholl, AOFM, *Committee Hansard*, 21 September 2012, p. 2.

40 Mr Robert Nicholl, AOFM, *Committee Hansard*, 21 September 2012, p. 2.

challenges, borrowers may also have legal recourse available to them as the allegations, if proven correct, would raise questions about the ability of a bank to rely on the loan application documents.

Information on conditions in the lending market

6.33 An issue raised during the inquiry was the improvement of information regarding lending activity. ASIC suggested that a dedicated senior loan officer survey be introduced in Australia to improve the examination of supply and demand conditions in the lending market. ASIC noted that these types of surveys are conducted in a number of other jurisdictions, including the US, UK, Japan and Europe, and 'have been useful in researching the lending demand and supply dynamics for bank loans for businesses and households'.⁴¹ One of ASIC's commissioners advised the committee:

It is beneficial for regulatory agencies to understand the conditions in the market, what sorts of practices are being pursued by lending institutions and how they are seeing the state of play in terms of the ability of borrowers to repay, what sorts of challenges borrowers might be facing in different economic conditions and that sort of thing. It adds to our understanding of any emerging risks in the market and for that reason it also helps us to, if you like, be a bit more proactive about the regulatory work we could do.⁴²

Committee view

6.34 A senior loan officer survey on lending practices may provide some useful and timely information about the state of the lending market for regulators, policy makers, market participants and market observers. The committee notes that such a survey is conducted by central banks in a number of other countries and does not consider that undertaking such a survey in Australia would be particularly expensive or burdensome. The committee supports further information about the state of the lending market being made publicly available.

Recommendation 6.1

6.35 That the Reserve Bank of Australia conducts, on a quarterly basis, a dedicated senior loan officer survey and publishes the results of these surveys.

41 ASIC, *Submission 97*, p. 5.

42 Mr Peter Kell, Commissioner, ASIC, *Committee Hansard*, 8 August 2012, p. 53.