

Ian Graham:
Defaults on low-doc
loans will increase
at a faster rate than
standard loans



RUN FOR COVER

HOME-LOAN INSURANCE
CLAIMS ARE ON THE RISE
AS PROPERTY PRICES
FALL, FORCING MORTGAGE
INSURERS AND LOW-DOC
LENDERS TO BUTTRESS
THEIR RISK MANAGEMENT
AND REVISIT CREDIT
UNDERWRITING POLICIES.



Australia's leading mortgage insurer is battering down the hatches and demanding higher standards from lenders as claims and arrears climb higher. The tightening by Genworth Financial highlights the need for improved risk-management in the home-loan industry as rising interest rates and stagnant property markets stretch consumers.

Home-loan insurance claims have escalated drastically in New South Wales, which has suffered the largest property price falls. For the year to December 2005, Australia-wide gross mortgage insurance claims were \$50 million – 46 per cent of which were in NSW and the ACT, according to the Australian Prudential Regulation Authority.

This compares with an Australia-wide figure of just \$11 million for mortgage insurance claims for the year to June 2005, including \$3 million each in claims for NSW, ACT, Queensland and Victoria.

Genworth wrote to several lenders in August after an internal review. "The objective of the review has been to help us identify the causes of a recent increase in our claims and arrears," the letter said. "Areas of the review include credit policy, underwriting practices, valuation practices and loss mitigation practices. One of the areas we have focused on is the quality and consistency of credit underwriting standards across the industry." The letter asks lenders to provide far more comprehensive documentation before mortgage insurance is granted.

Low-doc loans, which emerged during the heated market of 2002, are magnified in arrears statistics: default rates are nearly double those of standard loans. These loans are aimed at self-employed borrowers, or those who have income and assets, but cannot provide financial statements.

But instead of moving to price low-doc loans for risk, the Reserve Bank of Australia notes a growth in the value of low-doc loan approvals – and the disappearance of interest-rate risk pricing.

Genworth and PMI are the two leading mortgage insurers, with market shares of about 55 per cent and 45 per cent respectively – though several banks and building societies insure their own products.

Genworth's managing director in Australia and New Zealand, Peter Hall, says: "We were standardising our process [in requesting further documentation] because we've had different formats for different lenders.

"There is such a diversity of lenders in the marketplace, we are looking at consistency of standards. Our low-doc loans have higher delinquency rates, but not necessarily a higher claims rate."

Hall says the insurer helps lenders to manage their risk portfolios. "Over the previous five years we have seen the lowest levels of arrears in recent memory,"

he says. "Some customers have submitted very few claims, and now they're getting a claim. A lot of lenders have not got a lot of infrastructure and resources in their claims submitting sector. Our people are talking to lenders about how to manage a loan through the life of that loan, including [potential] recovery."

PMI chief executive Ian Graham says the industry is focusing on risk management. "A lot of products were developed over the boom and only now is the [mortgage insurance] industry looking at loss development," he says. "If losses are continually higher, underwriting policies will need to change." Australia has moved towards long-run default levels in the past year after years of low claims, he adds.

PMI had record low default rates of 0.13 per cent of loans that were 90 days or more in default during 2003-04. PMI's defaults are now 0.2 per cent, Graham says. "It may not seem much but it is a 50 per cent increase and will continue to rise. Our defaults are still low by international standards. But our average claim two years ago was \$20,000 and now it is \$60,000."

Graham says PMI does not foresee a change in processes in the next few months. "We will monitor our experience. Defaults on low-doc loans will continue to increase at a faster rate than standard loans. If [Genworth] is tightening on business that was previously written and should not have been written, it's unlikely PMI would want to write that business."

Some lenders claim business will suffer with Genworth's tighter approval process. "We are

The number crunch

Mortgage insurers reported \$625 million in gross premium revenue for the year to December 2005, according to the Australian Prudential Regulation Authority.

Lenders' mortgage insurance was used by 36 per cent of borrowers for their last home loan, the *Datamonitor/Genworth Financial Mortgage Trends Report 2006* shows.

Australians have healthy risk appetites. About 20 per cent of borrowers are prepared to use a product that enables them to buy property with no deposit, the *Datamonitor/Genworth* survey of 2000 people found. Nearly 40 per cent are willing to take out loans with loan-to-value ratios of 85 per cent or more.

While arrears for standard loans remained stable at 0.9 per cent to 1.0 per cent from April last year to July this year, arrears for low-doc loans increased from about 1.8 per cent to more than 2 per cent in the same period, the Reserve Bank of Australia says.

suffering with turnaround times," Mortgage Ezy executive director Peter James says. "Our head office is Queensland; now all loan approvals have to go to Sydney. We [used to] guarantee loan approval in 24 hours but now insurers are taking days to approve insurance."

James says Mortgage Ezy can use a balance-sheet lender instead of insurance, but that business will be affected in the next few months. Genworth has substantially increased its claim denials over the past three months, he says.

Hall denies the proportion of rejected claims has increased and insists service levels have not changed. "We track every transaction in our business on time frames and have service level agreements with providers," he says. "Every application has an answer in six hours."

If low-doc loan defaults increase – Fitch Ratings forecasts a move from 3.5 per cent in July to 4 per cent by year's end – lenders with substantial low-doc portfolios will be hit harder. Wholesale lender First Mac says low-doc loans comprise 40 per cent of its book; for Mortgage Ezy, it's about 50 per cent.

Mortgage Ezy is venturing into even riskier territory with non-conforming loans (which enable lending to clients with credit impairments). James says it is budgeting for arrears of about 10 per cent.

Challenger Financial provides home loans under its Interstar business, which sells products branded by companies such as Resi and Wizard. Challenger Mortgage Management's general manager of distribution, Steve Weston, says: "Until a month ago, with Genworth you could quite quickly [obtain loan] approval. Now they have to wade through paperwork like tax returns and bank statements."

Genworth's tighter processes are not new, Weston says. "If the approval process extends and our service is impacted we will lose our competitive advantage. But it's only the same as what they were asking for a few years back. PMI will be rubbing their hands, but may also be concerned about too much business possibly impacting their service levels."

Yet several players say Genworth's move is unlikely to lift PMI's business – which has a reputation for being conservative. On why many lenders favour Genworth, First Mac director of securitisation Andrew Chepul says: "You tend to take the path of least resistance." Another lender, which asked not be named, says Genworth's move to tighten loan approvals may lead consumers to use more uninsured products such as non-conforming loans.

Chepul says First Mac does not expect business to be badly affected by Genworth's change as it requires detailed submissions for approvals. "Delinquencies have been quite volatile for low-docs over the past 18 months, but enforcement [for arrears recovery] is consistent with prime loans." ●