Australian Mortgage Industry - Volume 3

Mortgage Industry Efficiency Reviewed

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This report is the result of a joint effort between Fujitsu Consulting and JPMorgan, focusing on developments in the Australian mortgage industry. We use the Fujitsu Mortgage Market and Yield Improvement Modelling.

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See page 34 for analyst certification and important disclosures, including investment banking relationships.

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Executive Summary

This report is the result of a joint effort between Fujitsu Consulting and JPMorgan, focusing on developments in the Australian Mortgage Industry. We use the Fujitsu Mortgage Market and Yield Improvement Modeling. In relation to the mortgage industry generally, the key findings are:

- **1QCY2006 sees housing loan growth re-accelerating given a stabilization of in national average housing prices and an increased willingness of borrowers to gear into residential property** - In November 2003 Australian housing mortgage credit 3 month annualized growth peaked at 23.4% before slowing to a low of 9.4% in September 2004. Thus far 1QCY2006 sees Australian mortgage loan outstandings surge 15% on an annualised basis to A$739.5bn in February 2006. The 1QCY2006 surge in housing credit growth, against the backdrop of further declines in construction activity, reflects a stabilization in national house prices (with further declines in Sydney house prices offset by surging prices in every other capital city) and an increased willingness by borrowers to borrow on higher LVRs (Loan to Valuation Ratio).
- **Rising LVRs see domestic households heavily leveraged into residential property and vulnerable to rising global interest rates -** In 2004 the number of households geared into property (35.1%) exceeded households with no mortgage borrowings for the first time (34.9%), with the system-wide Loan to Value ratio on all residential properties reaching an all time high of 22.2% and on geared properties rising to an estimated 33.8%. The LVR on new lending has resumed its upward trajectory and is estimated to be 59.2% on new lending. Unlike many other countries approximately 85% of home loan outstandings are at variable rates which means that the direct risk of rising global interest rates on this increased level of consumer indebtedness is borne directly by households not the banking sector.
- **Bank marketshares have stabilised but are distorted by differential rates of reliance on third party mortgage brokers. Banks are actively reinvesting in branch networks in an effort to regain strategic flexibility and the pricing power associated with the distribution function** - Based on Australian Prudential Regulation Authority (APRA) statistics to the end of February 2006 housing loan marketshares for the major banks have declined slightly, regional banks have stabilised and non-banks / foreign banks have picked up modest incremental housing share. However sales through the branch network are underperforming relative to sales through other channels, in particular third party mortgage brokers. As such we caution that overall housing marketshare data for individual banks continues to be distorted by the use of third party brokers which now account for an estimated 45% of new housing lending volumes. Banks continue to cede housing marketshare through their proprietary branch distribution channels. In response banks are now reinvesting in their branch networks in an effort to reclaim lost distribution. The continued tacit support of mortgage brokers by banks is weakening the distribution strength, and ultimately the pricing power, of the banks. In response to this, banks are reinvesting in their branch networks in order to reclaim lost distribution.
- **The internet is increasingly being used by mortgage borrowers as a price discovery mechanism but the bulk of borrowers still prefer face to face contact to close the deal.**

- **Having previously used mortgage brokers to arbitrage mortgage prices between banks customers are increasingly using multiple mortgage brokers to verify offerings.**
- **The non-bank mortgage intermediary industry is starting to consolidate.**
- **Based on normalised housing starts of circa 150,000pa and a typical "home renovation cycle" any growth in housing credit over and above 4% pa is entirely attributable to rising house prices and / or an increasing Loan to Valuation Ratio on new lending –** These dynamics were clearly demonstrated in the sharp slow down in housing loan growth over 2004 and 2005 and the sharp rebound over 1QCY2006. Conversely any weakness in national housing prices, particularly outside of Sydney, accompanied by a more conservative stance by new borrowers with regards to Loan to Valuation Ratios would trigger a sharp slowdown in housing lending growth.

We have also undertaken a detailed review of the operating efficiency of the Australian mortgage industry based on the Fujitsu Consulting Mortgage Industry Cost Index (MICI), comprising all the cost and fee related elements in the industry, adjusted for purchasing parity, but excluding interest charges. The MICI covers the cost of acquisition, maintenance and closure of a mortgage. On this basis Fujitsu Consulting have completed comparative economic analysis of the mortgage market in Australia, the United Kingdom, the United States, Canada and New Zealand. The key findings are:

- **Costs and fees charged to consumers in Australia are up to 35% higher compared with the US and united Kingdom mortgage markets.** Strong sectoral pricing power sees this higher structural cost base passed on to borrowers at a substantial relative cost to the broader economy. The high cost base of the Australian mortgage industry is explained by the small size of the Australian mortgage market and the historic oligopoly industry structure which has allowed participants to operate inefficiently. These dynamics suggest that industry players in Australia still have capacity to drive greater operating efficiency out of the mortgage business while reducing fees and maintaining profitability. In this regard we highlight major re-engineering of mortgage lending processing, servicing and credit processes by CBA under its CommWay and CommSee programs and WBC under its Pinnacle and Reach programs.
- **Process reengineering and automation could cut the operating costs of the Australian mortgage industry by at least 25%** - The detailed analysis completed by Fujitsu Consulting suggests that at least 25% of the mortgage sales cost can be removed from the mortgage supply chain through automating the interface between customers, lenders, lawyers and surveyors. This highlights the importance of smarter processing and the need to understand and implement industry best practice in order to gain an edge over competitors, both incumbents and new players. The wide gap in average mortgage origination costs between the top decile of Australian mortgage lenders at A$540 and the worst decile at A$1,349 highlights the potential savings available to the industry by improving the mortgage origination process.
- **Levers available to the Australian mortgage industry to improve operating efficiency** include:
    1. Introduce fast track processes for low risk conforming loans.
    2. Implement a streamlined “shopping” process built around Needs Based selling to tailor suitable product options.

3. Enable automated underwriting and “decisioning” via real time integration.
4. Deploy customer-centric, consistent processes across all contact points to enable faster processing of service and sales requests and an enhanced standardized customer experience.
5. The pro-active management of applications in progress by utilizing automated escalation management.
6. Fully integrated imaging, document management and workflow.
7. Automated provisioning integration with seamless automated funds requests and provisioning through Enterprise Application Integration to existing legacy financial systems.
8. Streamlined broker management with work only commenced on an application after an automated process has ensured 100% of data requirements have been supplied.
9. The establishment of a Single Customer View to enable cross-selling on an automated basis.

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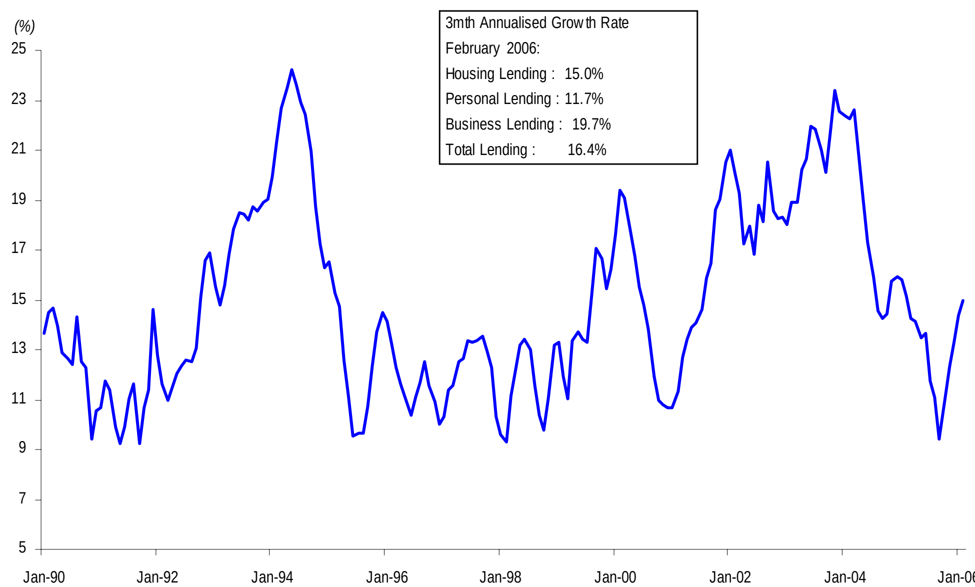
Mortgage Industry Update

Mortgage Industry Update

Thus far 1QCY2006 has seen a sharp rebound in the growth rate of Australian housing mortgage loan outstandings following a period of slowing housing growth over the last 2 years. Aggregate system home loan outstandings reached A$739.5bn as at the end of February 2006. We highlight recent developments as follows :

- **1QCY2006 sees housing loan growth re-accelerating** - Up until November 2003 Australian housing mortgage credit had shown phenomenal strength peaking at a 3 month annualized growth rate of 23.4% pa in November 2003 (refer Figure 1). CY2004 and CY2005 saw a sustained slide in housing credit growth to a low of 9.4% 3 month annualized in September 2004. Conversely thus far 1QCY2006 sees Australian mortgage loan outstandings surge 15% on an annualised 3 month rolling basis to A$739.5bn in February 2006.

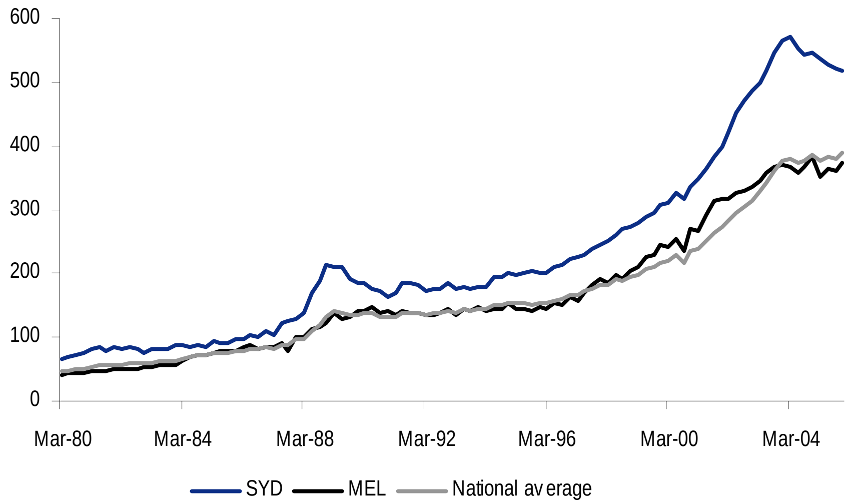
Figure 1: Australian Housing Lending Growth, 3mth Annualised



Source: RBA.

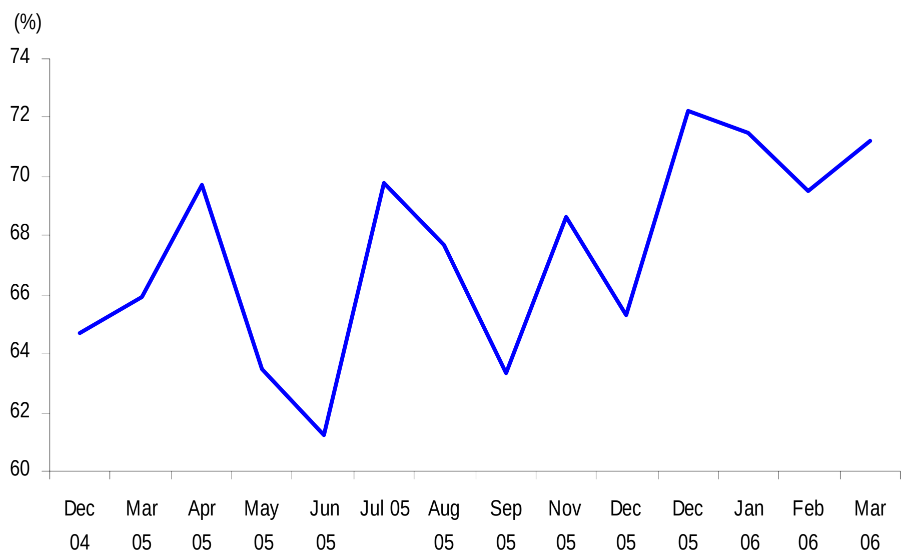
- **Rebounding 1QCY2006 housing growth reflects a stabilization in housing prices and an increased willingness of borrowers to gear into residential property** – The CY2004 and CY2005 slowdown in housing credit growth had reflected the burden of falling house prices, slowing construction activity and an apparent more conservative stance by borrowers, as measured by a declining LVR (Loan to Valuation Ratio) on new lending. Home loan volume growth had fallen from a peak annualized 23.4% in the 3 months to November 2003 to an annualized 9.4% in the 3 months to September 2005 before rebounding to an annualized 15.0% in the 3 months to February 2006 (refer Figure 1). The rebound in housing credit growth, against the backdrop of further declines in construction activity (refer Figure 4) reflects a stabilization in national house prices (with further declines in Sydney house prices offset by surging prices in every other capital city - refer Figure 2) and an increased willingness by borrowers to borrow on higher LVRs (Loan to Valuation Ratio) (refer Figure 3).

Figure 2: Median Australian House Prices



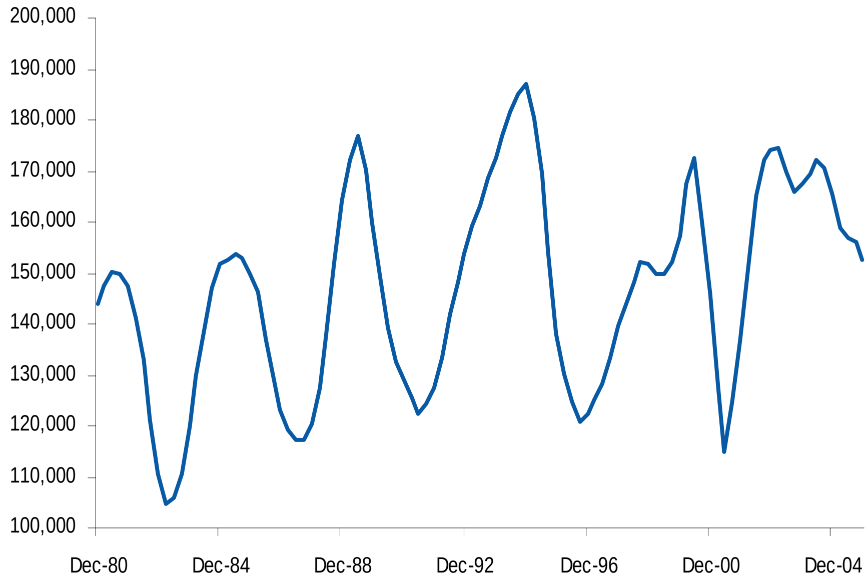
Source: Real Estate Institute of Australia.

Figure 3: New Lending LVR For Mortgage Broker AFG



Source: AFG.

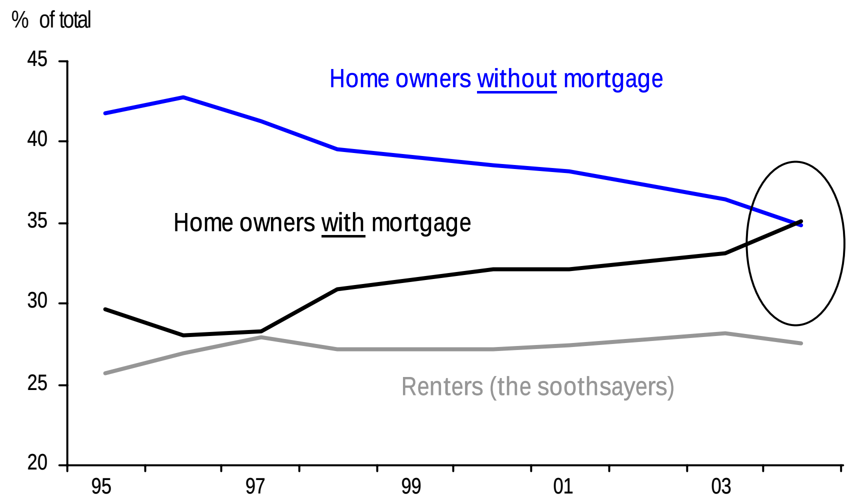
Figure 4: Australian Housing Starts



Source: ABS.

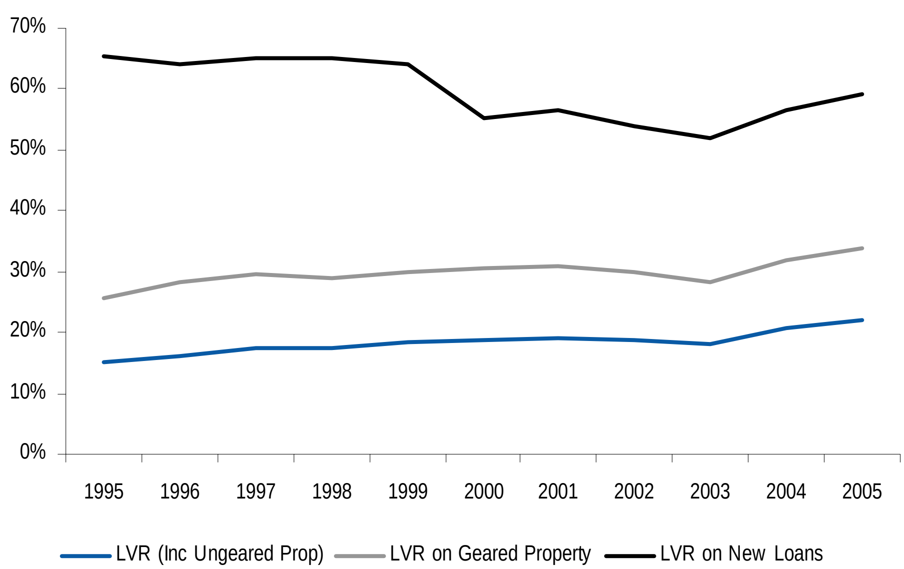
- **In 2004 the number of households geared into property exceeded households with no mortgage borrowings, with the system-wide Loan to Value ratio on all residential properties reaching an all time high of 22.2% and on geared properties rising to an estimated 33.8%. The LVR on new lending has resumed its upward trajectory** - As detailed in Figure 5 the willingness of Australian households to gear into residential properties saw the number of households with a mortgage (35.1%) exceed the number of householders without a mortgage (34.9%) for the first time in December 2004. Before allowing for those households without mortgages this sees the ratio of all housing debt to all residential property value at 22.2%, however this increases to 33.8% if the 34.9% of non-mortgaged households are excluded as compared to an estimated new lending LVR of 59.2% as at December 2005 (refer Figure 6).
- **Unlike many other countries approximately 85% of home loan outstandings are at variable rates which means that the risk of rising global interest rates on this increased level of consumer indebtedness is borne directly by households not the banking sector**.

Figure 5: Status of Households – Mortgages vs No Mortgages vs Renters



Source: RBA, ABS.

Figure 6: Estimated Australia Home Loan LVR Dynamic

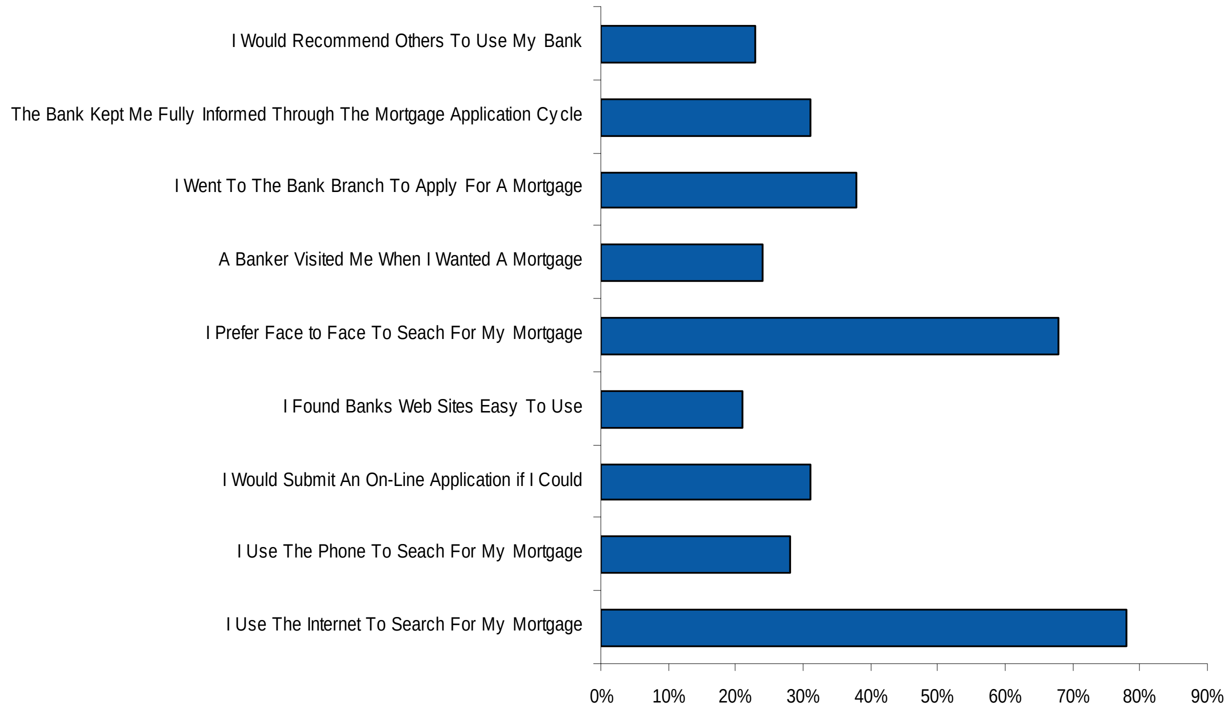


Source: ABS, APRA, RBA, Real Estate Institute of Australia, JPMorgan.

- **Based on Australian Prudential Regulation Authority (APRA) statistics to the end of February 2006 housing loan marketshares for the major banks have declined slightly, regional banks have stabilised and non-banks / foreign banks have picked up modest incremental housing share** – The APRA based marketshare and annualized growth rates for each of the banks in housing lending are detailed in Table 4 and Table 5 respectively in the Appendix to this report.

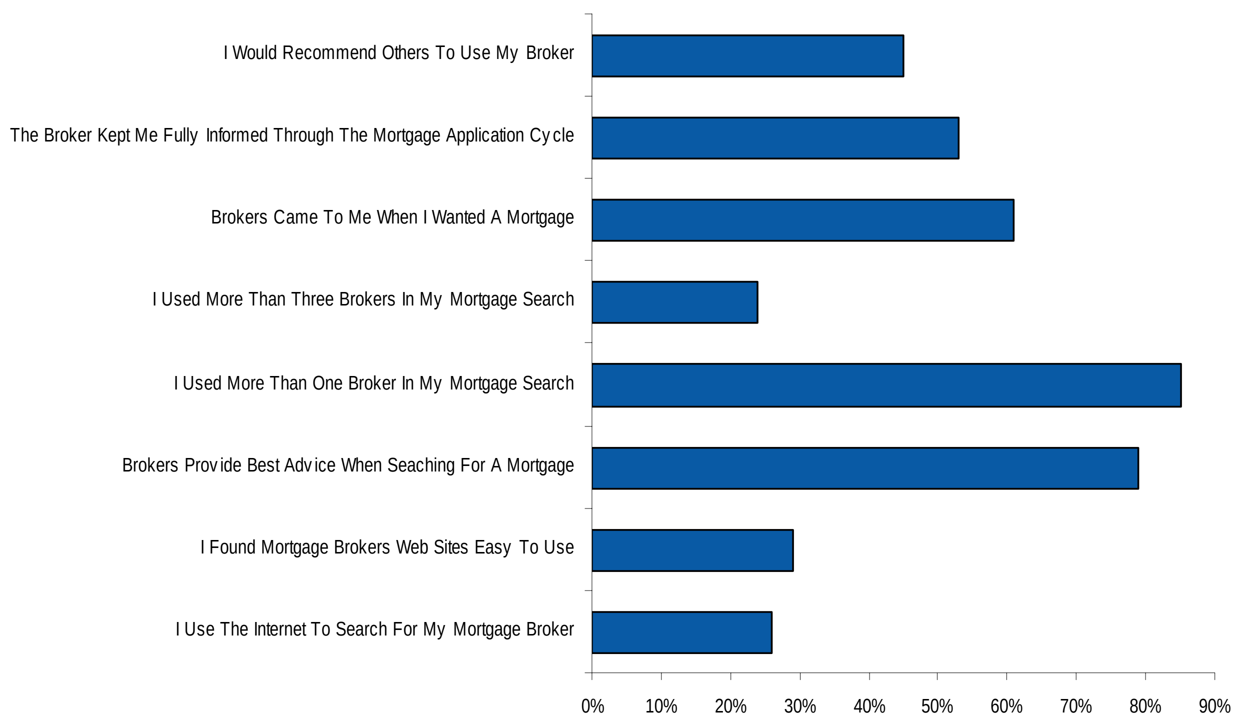
- **Generally, sales through the branch network are underperforming relative to sales through other channels** – As illustrated in Table 2, each of the major banks has lost market share in their branch networks, with the notable exception of ANZ. This market share loss continues to occur despite significant reinvestment in branch networks, particularly by CBA and ANZ, after long periods of branch closures and disinvestment. As such we caution that overall housing marketshare data for individual banks continues to be distorted by the use of third party brokers which now account for an estimated 45% of new housing lending volumes. The majority of banks continue to cede housing marketshare through their proprietary branch distribution channels. By way of example the stabilisation of CBA's marketshare is entirely a function of increased reliance on third party broker originated loans where as its proprietary distribution channel marketshare continues to decline by 1% pa (refer Table 2). At the release of the 1H06 result and again during the March 2006 strategy briefing CBA attribute the declining proprietary channel marketshare to the poor performance of the Premium Financial Services business and not the retail branches. Regardless of the reason improving the home loan distribution performance of CBA's proprietary channels is a major focus of new CBA CEO Ralph Norris as the Cohen Brown sales and service model is rolled out in Australia. Similarly the steady erosion in WBC's home loan marketshare is largely explained by its poor penetration of the broker distribution channel rather than any relative under performance by its proprietary channels (refer Table 2). With WBC's Pinnacle "process automation" program and Reach CRM program now operational the performance of WBC's proprietary branch distribution channels is now expected to improve.
- **The internet is increasingly being used by mortgage borrowers as a price discovery mechanism but the bulk of borrowers still prefer face to face contact to close the deal** – Fujitsu Consulting surveyed 2,000 respondents in its regular omnibus survey regarding their buying behavior regarding mortgage products. As detailed in Figure 7 the major outcomes were that (i) 78% of respondents seeking a mortgage use the internet as part of their search, (ii) 68% prefer face to face contact in searching for a mortgage product, (iii) around 30% of customers would be prepared to submit an online application for a mortgage, (iv) Less than 40% of customers went to a branch to apply for a mortgage, and (v) a little over 20% of customers were willing to recommend their bank to a friend or relative.
- **Having previously used mortgage brokers to arbitrage mortgage prices between banks customers are increasingly using multiple mortgage brokers to verify offerings** – The perceived "independence" of mortgage brokers may now be waning. As detailed in Figure 8 (i) over 85% of customers now use more than one broker in searching for a mortgage with over 20% using more than three brokers, (ii) however 79% of customers still believe mortgage brokers provide the best advice on a mortgage, (iii) 29% of customers found broker web sites easy to use vs only 21% for bank web sites (refer Figure 7), and (iv) 61% of customers stated the broker came to them when they wanted a mortgage vs only 21% for bank customers (refer Figure 7).

Figure 7: Bank Channel Interaction



Source: Fujitsu Consulting.

Figure 8: Broker Channel Interaction



Source: Fujitsu Consulting.

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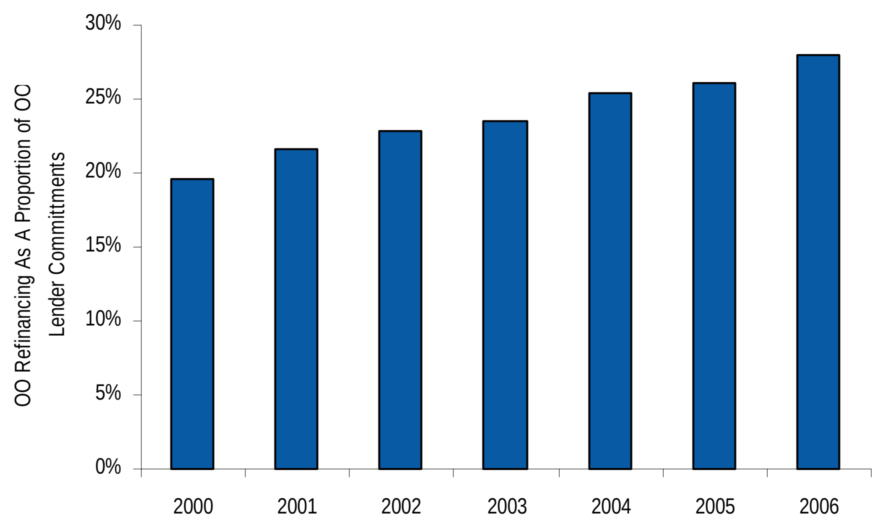
- **Owner occupied re-financing is making up a larger share of total loans** – Refinancing as a proportion of owner occupier commitments continues to increase which is likely contributing to increasing systemic LVRs and creating the opportunity for marketshare shifts (Figure 9). Significantly mortgage brokers are capturing a larger share of refinancing than other channels. The Reserve Bank of Australia (RBA) highlighted in its September 2004 Financial Stability Report that the current commission structures exacerbate this trend because of the importance of upfront commissions.

Figure 9: Owner Occupied Refinancing



Source: Fujitsu Consulting estimates.

- **Mortgage market participants have reacted to slowing volume growth by offering lower rates and "attractor" packages** – Examples of the former include Wizard's aggressive standard variable rates and WBC's recent fixed rate offers. At the same time, examples of the latter include NAB's "Triple Saver" package deal. Furthermore all of the banks are increasingly promoting substantial rate discounts of at least 70bp on their respective discounted "professional choice" package offerings. To some extent this reduces the churn of marketshare to rivals but it will accelerate back-book repricing downwards as the heritage "standard variable rate" home loan portfolio is replaced by the new discounted "professionals choice" loan portfolio (refer Figure 15).

- **The proportion of broker originated home loans continues to rise** – The proportion of broker originated home loans has risen to around 35% despite recent efforts by some banks to reinvigorate internal channels (such as ANZ and WBC) and to reduce commissions paid to brokers (such as ANZ and CBA).

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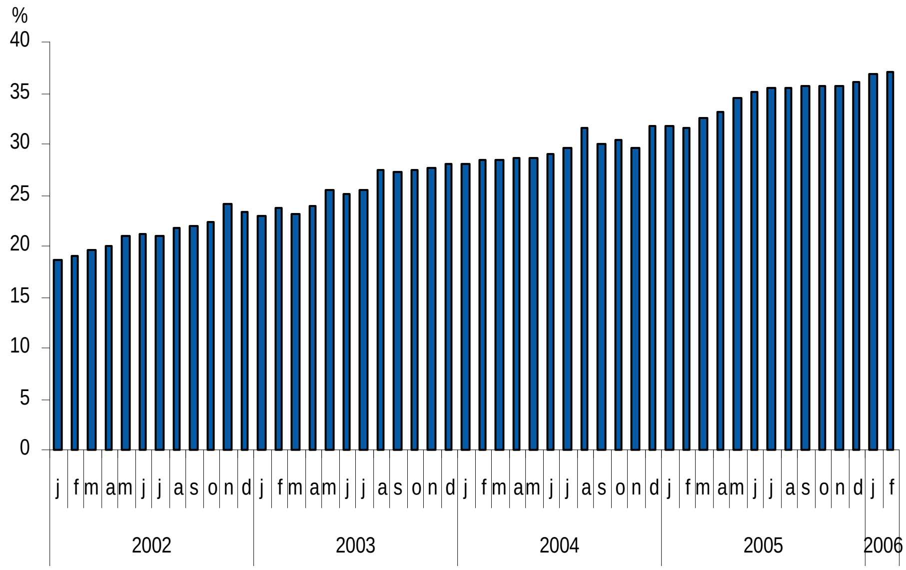
Figure 10: Broker Originated Loans as a Proportion of Total Housing Loans Outstanding



Source: Fujitsu Consulting estimates.

- **Major banks' reliance on brokers is still increasing but banks must act to reclaim the pricing power associated with the distribution function** – In the 4QCY2005 and again in 1QCY2006 the reliance of the major banks on third party broker originated mortgages remains high (refer Figure 12). As detailed in Table 1 we highlight that we believe this growing dependence on third party mortgage brokers represents a major point of emerging strategic weakness for the major banks. As such we note that the recent trend by all of the major banks to reinvest in their proprietary branch networks, after many years of active dis-investment, may well be the harbinger of a major shift by the incumbent banks to "wean" themselves off this potentially value destroying distribution channel by way of a program of aggressive discounting through their own proprietary channels. The massive reduction in branch numbers and labour shedding undertaken by the banks in the late 1990s had resulted in banks increasingly outsourcing incremental home loan origination to third party mortgage brokers. While the high housing spreads allowed banks to maintain profitability, spreads are falling in response to competition, with the impact being absorbed by lenders rather than brokers. The continued tacit support of mortgage brokers by banks is weakening the distribution strength, and ultimately the pricing power, of the banks. In response to this, banks are reinvesting in their branch networks in order to reclaim lost distribution capacity and preserve pricing power. As such we highlight a subtle change in the relationship between banks and mortgage brokers. The traditional arrangement saw banks undertaking not to offer cheaper loans through their own channels than those offered through the broker channel. However these agreements are breaking down with a number of banks offering exclusive low rate offers through their proprietary branch and direct channels.

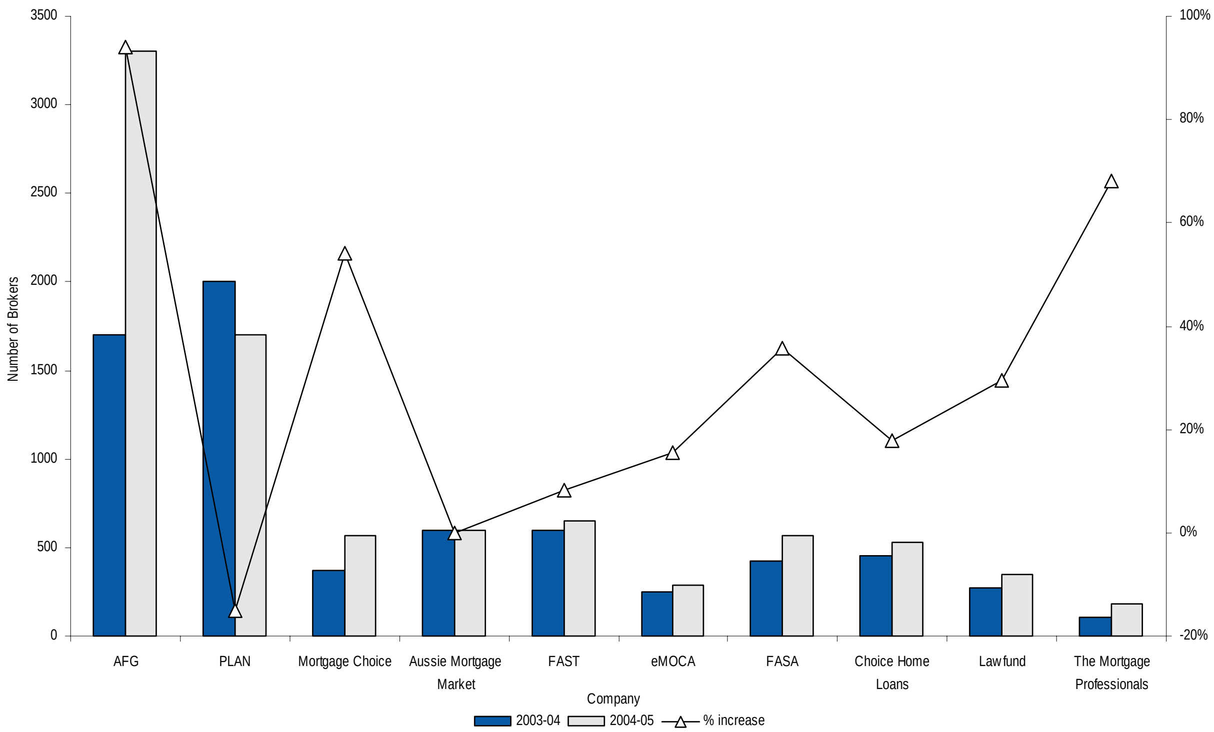
Table 1: Strategic Positioning of Australian Banks in Housing Lending

	FY05 / 1H06		Medium Term Outlook
Mortgage Broker Flow	ANZ (2H05)	37%	Likely +50%
	CBA (1H06)	32%	
	NAB (2H05)	30%	
	WBC (2H05)	35%	
	SGB (2H05)	44%	
% of Balances Originated By Brokers	ANZ (2H05)	43%	Likely +50%
	CBA (1H06)	22%	
	NAB (2H05)	30%	
	WBC (2H05)	29%	
	SGB (2H05)	38%	
Commisions Paid	Est 4% of NPBT		Likely greater than 7% of NPBT
Commission Rates	Upfront 65bp Trail 20bp pa		Likely unchanged as brokers direct flow based on commission levels
Banks Strategic Positioning	Manufacturer & Distributor		Less of Distributor More Manufacturer
Banks Pricing Power	Strong but weakening as new players emerge		Weaker as Brokers and new entrants squeeze existing wide housing spread
Barriers to New Entrants	Disappearing as access to third party distrbutors with no drag of funding proprietary branch Network.		No barriers to entry as new entrants exploit full access to market via third party brokers

Source: JPMorgan.

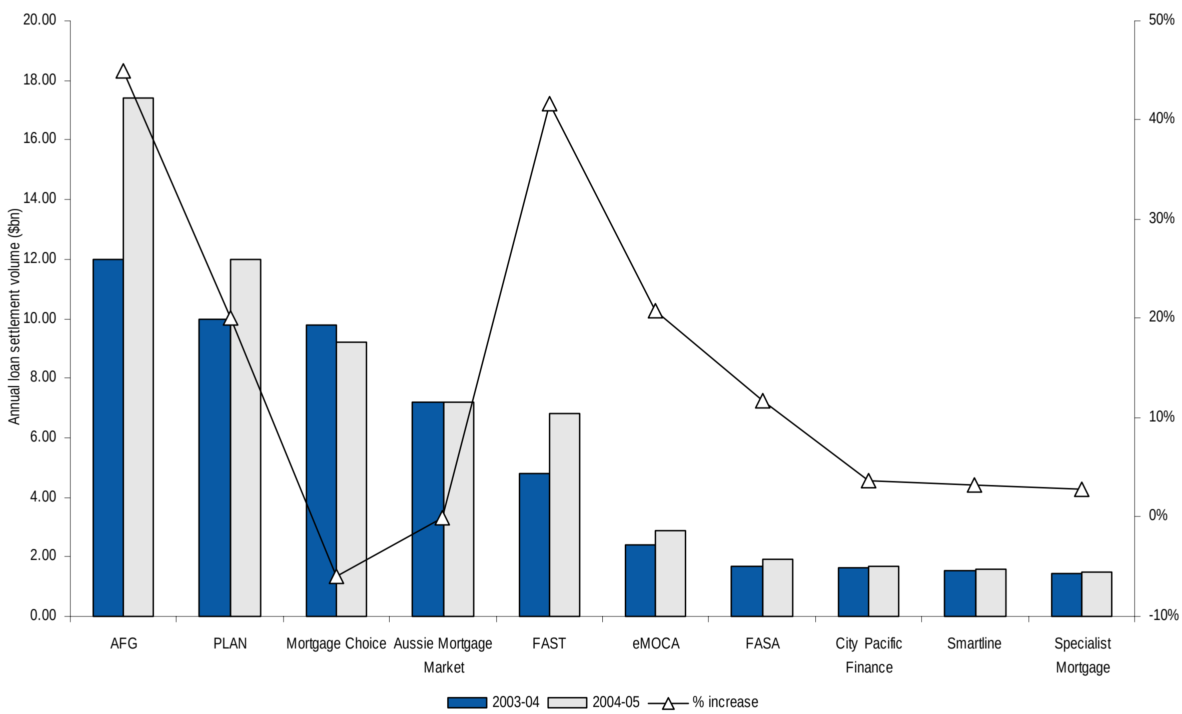
- **The non-bank mortgage intermediary industry is starting to consolidate –** As detailed in Figure 11 and Figure 12 the mortgage broking industry is dominated by a small number of large players including AFG, Plan and Mortgage Choice. AFG and FAST have grown the fastest over the last twelve months with the number of mid-sized players significantly reduced due to consolidation. Many of the large players are consolidating their position by expanding their broker networks. This sees operating scale emerging as a major driver in the mortgage broker market with the requirement to provide good broker technology, training and support while supporting large marketing budgets favoring large mortgage brokers over the smaller mortgage broking operations.

Figure 11: Australian Top 10 Mortgage Brokers - By Number of Brokers



Source: Fujitsu Consulting estimates.

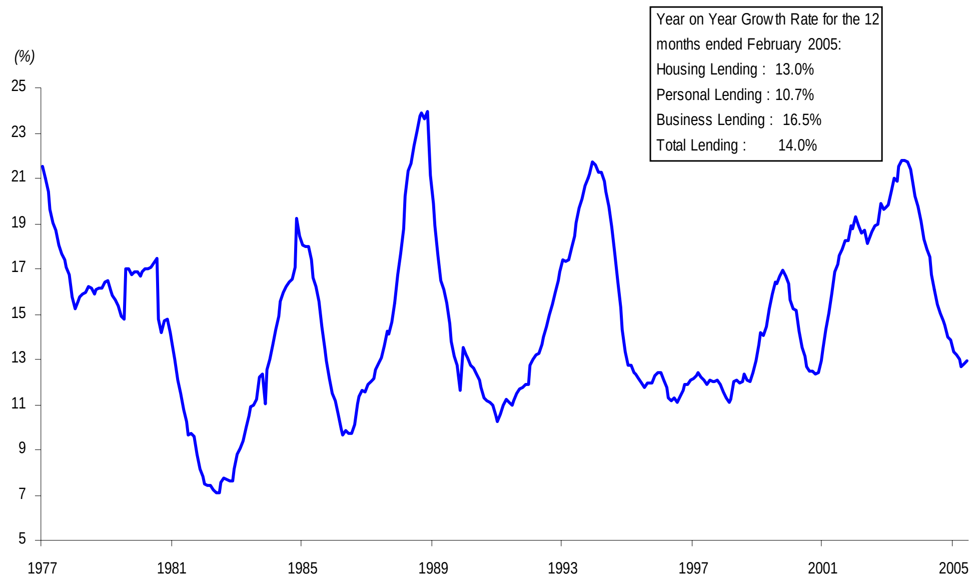
Figure 12: Australian Top 10 Mortgage Brokers - By Annual Settlement Volume



Source: Fujitsu Consulting estimates.

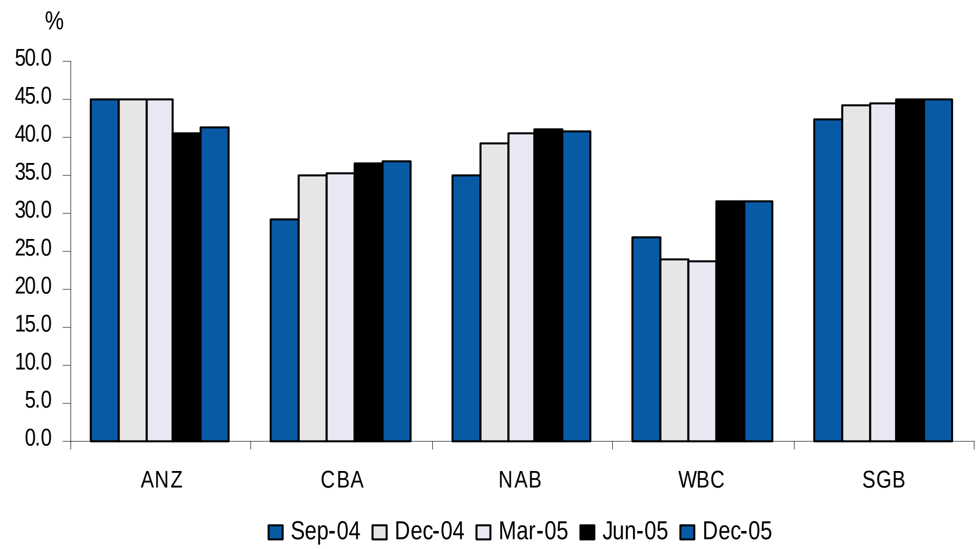
- **Based on normalised housing starts of circa 150,000pa and a typical "home renovation cycle" any growth in housing credit over and above 4% pa is entirely attributable to rising house prices and / or an increasing Loan to Valuation Ratio on new lending** – These dynamics were clearly demonstrated in the sharp slow down in housing loan growth over 2004 and 2005 and the sharp rebound over 1QCY2006 (refer Figure 1). Conversely any weakness in national housing prices, particularly outside of Sydney, accompanied by a more conservative stance by new borrowers with regards to Loan to Valuation Ratios would likely trigger a sharp slowdown in housing lending growth.

Figure 13: Long Term Australian Housing Lending Growth



Source: RBA.

Figure 14: New Third Party Originated Housing Loans by Lender



Source: Fujitsu Consulting estimates.

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Table 2: Australian Bank Housing Loan Market Share – Branch Originated vs. Broker Originated

	ANZ				CBA				
Outstanding Loans	1H04	2H04	1H05	2H05	1H04	2H04	1H05	2H05	1H06
On Balance Sheet	67.7	78.7	84.5	89.6	97.7	104.8	115.3	119.1	126.9
Securitised Home Loans	1.1	2.3	1.9	1.6	5.3	7.6	6.4	10.8	9.1
Gross Home Loans	68.8	80.9	86.4	91.2	103.0	112.4	121.7	129.9	136.0
Balance Of Which Originated by									
Branches	59%	58%	57%	57%	87%	84%	81%	79%	78%
Third Parties	41%	42%	43%	43%	13%	16%	19%	21%	22%
Total	100%	100%	100%	100%	100%	100%	100%	100%	100%
System Home Loans (Incl Sec'n)	572.5	616.0	660.9	697.9	544.0	595.6	639.2	682.4	717.9
Gross Home Loan Marketshare	12.02%	13.14%	13.07%	13.06%	18.93%	18.87%	19.04%	19.04%	18.94%
Balance Of Which Originated by									
Branches	7.09%	7.62%	7.45%	7.45%	16.47%	15.85%	15.42%	15.04%	14.78%
Third Parties	4.93%	5.52%	5.62%	5.62%	2.46%	3.02%	3.62%	4.00%	4.17%
	NAB				WBC				
Outstanding Loans	1H04	2H04	1H05	2H05	1H04	2H04	1H05	2H05	
On Balance Sheet	89.3	94.0	100.5	105.4	85.2	89.4	90.7	96.0	
Securitised Home Loans	0.5	2.8	2.3	1.9	2.7	2.3	3.8	3.1	
Gross Home Loans	89.8	96.8	102.8	107.3	87.8	91.7	94.5	99.0	
Balance Of Which Originated by									
Branches	75%	75%	72%	70%	77%	74%	73%	71%	
Third Parties	25%	25%	28%	30%	23%	26%	27%	29%	
Total	100%	100%	100%	100%	100%	100%	100%	100%	
System Home Loans (Incl Sec'n)	572.5	616.0	660.9	697.9	572.5	616.0	660.9	697.9	
Gross Home Loan Marketshare	15.68%	15.72%	15.55%	15.38%	15.34%	14.89%	14.30%	14.19%	
Balance Of Which Originated by									
Branches	11.76%	11.79%	11.20%	10.77%	11.82%	11.02%	10.44%	10.08%	
Third Parties	3.92%	3.93%	4.35%	4.61%	3.53%	3.87%	3.86%	4.12%	

Source: Company, JPMorgan estimates.

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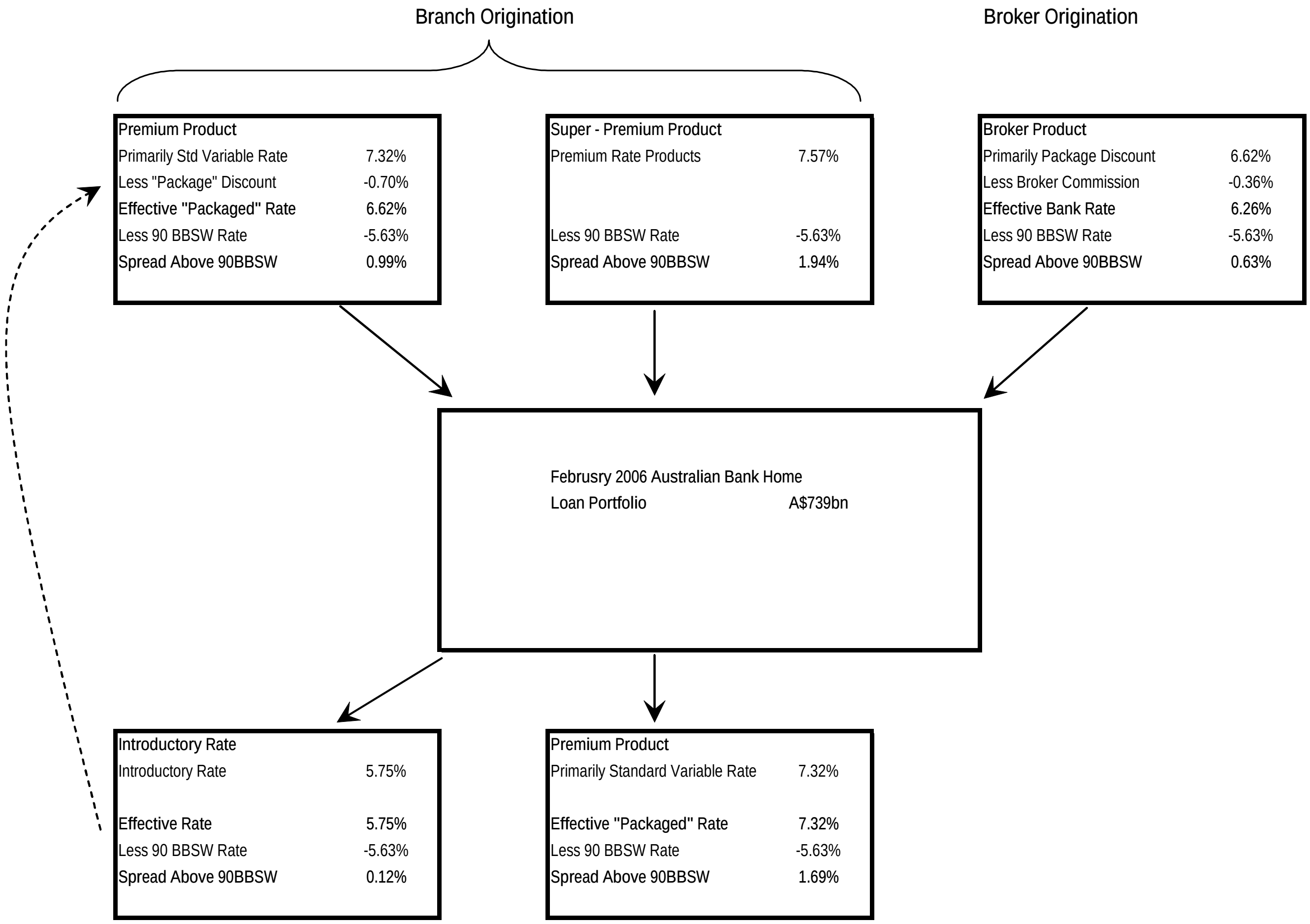
Figure 15: Australian Housing Loan Portfolio Back Book Repricing



Source: Company, JPMorgan estimates.

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Operating Efficiency Analysis

Mortgage Industry Operating Efficiency Analysis

In this third volume of the Australian Mortgage Industry we focus on the operating cost profile of the Australian mortgage industry. Operating efficiency will become an increasingly critical issue for the Australian banking sector going forward given the confluence of -

1. Emerging competitive pressures from new entrants on lending and deposit margins,
2. Burgeoning capital expenditure bills on IT system and compliance issues, and
3. The need to reinvest in the proprietary branch networks to recapture the pricing power and strategic flexibility flowing from the critical home mortgage distribution function (refer Table 1).

In order to assess the operating efficiency of the mortgage businesses of the Australian banks Fujitsu Consulting have calculated a Mortgage Industry Cost Index (MICI), comprising all the cost and fee related elements in the industry, adjusted for purchasing parity, but excluding interest charges. The MICI covers the cost of acquisition, maintenance and closure of a mortgage. On this basis Fujitsu Consulting have completed comparative economic analysis of the mortgage market in Australia, the United Kingdom, the United States, Canada and New Zealand.

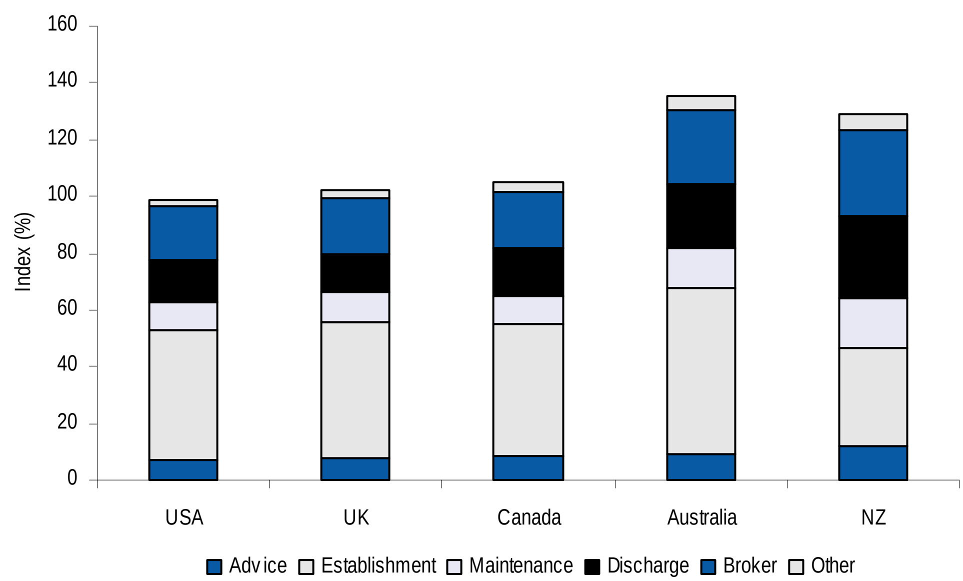
As detailed in Figure 16 costs and fees charged to consumers in Australia are up to 35% higher compared with the US and united Kingdom mortgage markets. Strong sectoral pricing power sees this higher structural cost base passed on to borrowers at a substantial relative cost to the broader economy. The high cost base of the Australian mortgage industry is explained by the following factors –

- The Australian mortgage market is far smaller than those in the US and United Kingdom so operating scale works against the Australian industry,
- Historically competition has been less severe in Australia because of greater industry concentration. For many years the absence of a third party broker distribution channel saw the branch networks of the incumbent major banks representing a major barrier to entry in terms of both mortgage distribution and deposit funding. Conversely the establishment of both a viable third party distribution channel, alternative direct distribution channels and home loan securitisation markets sees these barriers to entry evaporating and new players entering the market,
- In the absence of competition the relative operational inefficiencies of all of the existing mortgage players were easily funded by high lending spreads and there was no strategic imperative, or investment case, to lift operational efficiency of the mortgage industry,
- Mortgage commission rates paid to third party brokers are substantially higher in Australia (say 65bp upfront plus 20bp trailing commission) than overseas where trailing commissions are less prevalent (refer Table 3). Not only does the high mortgage lending spread in Australia support a high operating cost structure but also a substantially higher mortgage broker commission structure than is seen overseas.

- The average duration of a mortgage loan is far shorter in Australia than in other countries (ie Estimated Mortgage Duration – Australia: 3 years, US: 7.5 years, United Kingdom: 4.5 years, New Zealand: 4 years, Canada: 5.5 years). Given the relatively high cost of originating a mortgage in Australia (ie between A$540 and A$1,349 refer Figure 17) the short duration of Australian mortgages is problematic.
- Australian mortgage borrowers pay relatively higher fees and charges than in other countries, including in some cases higher valuation fees, monthly account keeping fees and higher discharge fees. Generally fees and charges have been growing in size and number as lending margins have been squeezed. However Australian mortgage lending margins are still higher than those overseas (Estimated Mortgage Spread - Australia: 1.25%, United Kingdom: 0.80%, US: 0.85%).

These dynamics suggest that industry players in Australia still have capacity to drive greater operating efficiency out of the mortgage business while reducing fees and maintaining profitability. In this regard we highlight major re-engineering of mortgage lending processing, servicing and credit processes by CBA under its CommWay and CommSee programs and WBC under its Pinnacle and Reach programs.

Figure 16: Home Lending Comparisons (excluding interest charges)



Source: Fujitsu Consulting estimates.

Table 3: International Mortgage Broking Commission Comparison

Country	Commission Structure	Degree Of Regulation	Trailing Commissions	Broker Share of New Loans
US	Brokers on sell loans from wholesale lenders, and add a mark-up that typically ranges from 0.5 to 1.5 points. 1% to 1.5% of a mortgage value is the typical total fee	Medium and increasing State level regulation in place. Accreditation provided by a number of professional bodies	Not paid	60%
UK	Mortgage brokers claim commission rates as high as 1.5pc on settlement They may also charge up to 1% of the borrowed amount for advice.	Medium and increasing. Brokers regulated by the Financial Services Authority (FSA) from October 31 2004	Not paid	65%
Canada	0.5 percent to 1.25 percent of the mortgage amount, depending on the length of the term Some charge advice fee initially	Medium and increasing State level regulation and licensing in place	Not paid	40%
Australia	Brokers typically charge 0.65% upfront and trailing commissions are around 0.20%. Many lenders have deferred establishment fees, but these are charged to borrowers, not brokers	Low but increasing	Are paid, typically 0.20% for either the duration of the loan, or a set number of years	45%

Source: Fujitsu Consulting estimates.

The detailed analysis completed by Fujitsu Consulting suggests that at least 25% of the mortgage sales cost can be removed from the mortgage supply chain through automating the interface between customers, lenders, lawyers and surveyors. The following are benchmarked industry averages for the Australian mortgage industry –

- 16 working days from receipt of application to issue of first offer,
- 52 working days from receipt of application to completion and funds transferred,
- 8% of applications received are declined during the application processing stage,

These statistics highlight the importance of smarter processing and the need to understand and implement industry best practice in order to gain an edge over competitors, both incumbents and new players. The wide gap in average mortgage origination costs between the top decile of Australian mortgage lenders at A$540 and the worst decile at A$1,349 highlights the potential savings available to the industry by improving the mortgage origination process (refer Figure 17).

Further Fujitsu Consulting have completed detailed analysis of the individual mortgage origination cost profiles across various product sets across lenders. The absolute cost of loan origination is not only determined by the origination function, but also by product features. As detailed in Figure 18 the results are far from generic across the industry. Furthermore the analysis suggests that some of the smaller regional players actually have lower mortgage loan origination costs than the major banks.

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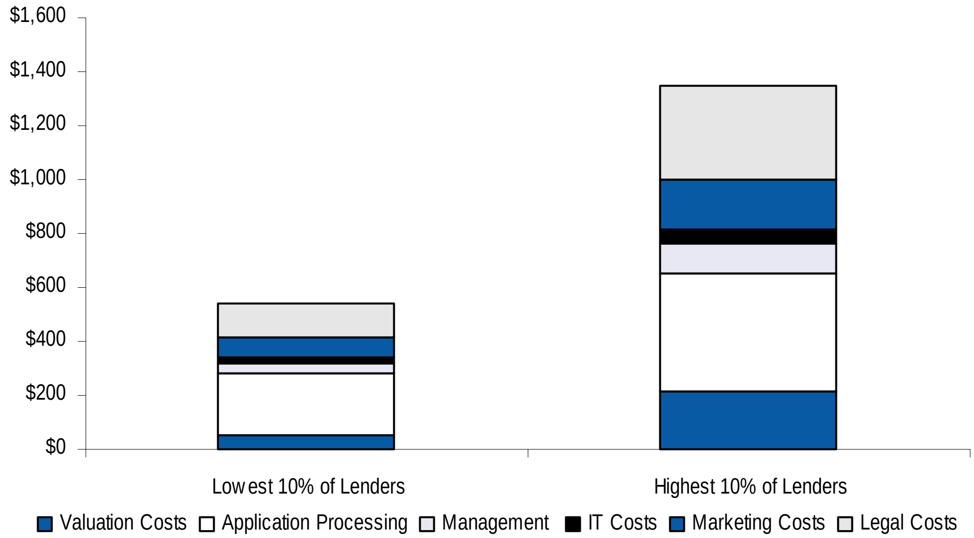
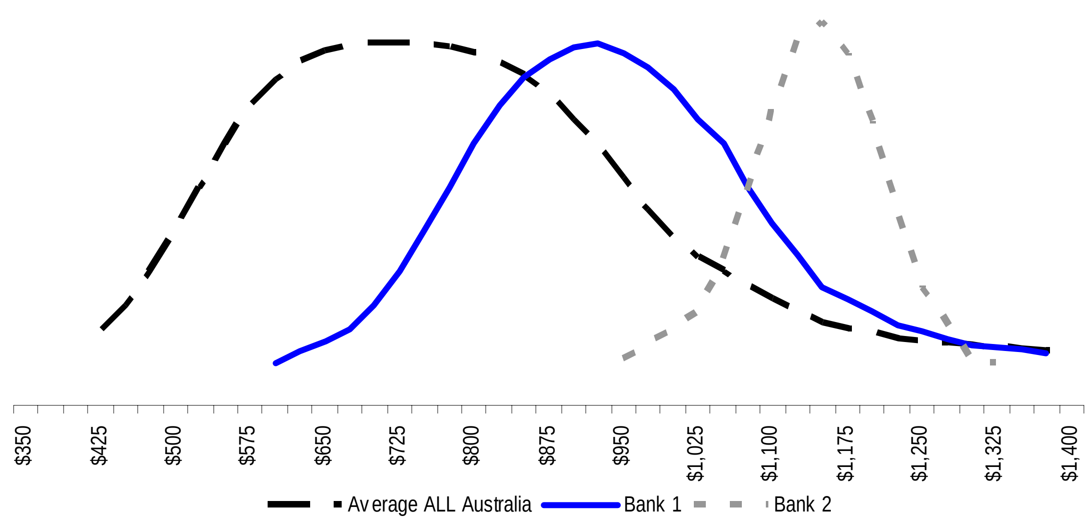
Figure 17: Average Mortgage Origination Costs



Source: Fujitsu Consulting estimates.

Figure 18: Mortgage Origination Cost Profile By Lender



Source: Fujitsu Consulting estimates.

On the basis of this analysis Fujitsu Consulting have identified the following levers available to the Australian mortgage industry to improve operating efficiency –

1. Introduce fast track processes for low risk conforming loans. This has reduced operational costs by over 20% in mortgage lending sites in the United Kingdom. Many main-stream lenders in the United Kingdom have changed their processes by introducing "fast-track" products to counter "self-certification" competitors. Conversely the savings from such a move should be assessed against the potential increase in operational risk thus carried by the lender and the potential for an increased regulatory capital / ratings agency capital requirement on "fast track" mortgage loans.
2. Implement a streamlined "shopping" process built around Needs Based selling to tailor suitable product options. This enables faster sales cycles and rapid elimination of "tire kickers" to reduce the overall cost to serve.
3. Enable automated underwriting and "decisioning" via real time integration. Online credit checking can allow early pre-approval of applications to drive a higher sales application conversion rate.
4. Deploy customer-centric, consistent processes across all contact points to enable faster processing of service and sales requests and an enhanced standardized customer experience. The benefits of consistent process are especially evident in high volume environments where process metrics become important in understanding operational trends. These statistics can also be used for continuous business process improvement programs by supporting "lean manufacturing" or six sigma initiatives.
5. The pro-active management of applications in progress by utilizing automated escalation management.
6. Fully integrated imaging, document management and workflow.
7. Automated provisioning integration with seamless automated funds requests and provisioning through Enterprise Application Integration to existing legacy financial systems.
8. Streamlined broker management with work only commenced on an application after an automated process has ensured 100% of data requirements have been supplied.
9. The establishment of a Single Customer View to enable cross-selling on an automated basis. Information on all products within a customer's financial portfolio is aggregated enabling automated cross-selling initiatives to be activated from savings, investments and all other areas of a mortgage lenders financial services business.

Fujitsu Consulting acknowledges the contribution of Graham technologies to this section of the report.

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Half An Hour with Phil Naylor

Half an Hour with Phil Naylor – Chief Executive Officer - Mortgage Industry Association of Australia

Given the growth in Broker Originated Loans, do you see the role of the MIAA having to change going forward?

Our role is changing, but not primarily because of broker originated loans. We cover numerous parties and represent all parts of the mortgage industry.

The upcoming regulation of brokers will change the balance of our focus. We have historically been the default regulator. In light of the upcoming regulation, we will be able to devote more focus to other important platforms, i.e providing value add to members and better promoting membership to the public.

However, given that around 90% of our members are brokers, we will no doubt always have a focus on broker issues.

What proportion of the broker market is directly associated with MIAA?

It is difficult to provide hard figures but our estimate is that at least 70% of all people calling themselves mortgage brokers are members.

We have over 11,000 members and more than 10,500 are individual brokers or broking businesses.

About 20% of our broker membership are part time in the sense that they are often involved in other businesses as well as doing some broking and we think that very few of the brokers who aren't members would be working in broking full time.

MIAA broker members write over 80% of the all broker-initiated transactions in the mortgage sector and all MIAA intermediary members including mortgage managers and non-bank lenders write in excess of 50% of all mortgages each year.

How similar are commission rates and structures between lenders today? Do you expect to see changes in structure and rates going forwards?

The MIAA is not involved in setting commissions and we don't study them.

Our anecdotal evidence is that commissions, in general across all lenders, are in a narrow band. The fact that commissions paid by major bank lenders which dominate the loans written by brokers are all very similar supports this.

Can you give details of the MIAA accreditation processes? How many applications fail to meet the requirements?

As our membership grew from 7,000 to 11,000 members in the past two years, we knocked back 30 applications. So we basically knocked back 30 out of around 4,000 who applied in that period. However we know that, because of our stringent membership criteria (industry experience, education and probity checks) which is well publicised on our web site and in application forms, many simply do not even bother to apply to become a member, which is good for the industry.

What is the significance of LIXI for lenders and brokers in Australia?

LIXI is a uniform standard of electronic communication in the mortgage industry. It basically represents one standard 'railway gauge' for everyone in the industry.

That will improve the efficiency of all involved in the loan process.

Is the Broker Industry self regulation defendable?

We (the MIAA) have never defended self-regulation as an end in itself. We established our regulatory regime in the absence of any nationally consistent government regime, and we have lobbied since 2002 to have the essence of our regime apply to all in the industry.

The biggest risk of regulation is that it doesn't reflect the risk to the consumer. The depth and breadth of regulation should reflect the risk of dealing with a broker. For example, the risk associated with a consumer dealing with a financial planner and that of dealing with a broker, is different. So the level and type of regulation should be different and should reflect the risk.

What is MIAA's position on the issue of "soft commissions"?

We established a Code on Alternative Remuneration in October 2004 and as this has worked well we don't see soft commissions as a key issue now but the Code is there to ensure people conduct themselves appropriately.

What is the biggest change you expect to see in the Broker led sector of the market?

Increased regulation is of course one of the biggest changes to come.

We are already seeing more consolidation in the broker sector but the evidence is that there will always be a small but healthy independent sector. We are also seeing more alliances and joint ventures with financial planners. The alliances with the financial planners can create value for customers, but care has to be taken to ensure that customers don't feel they are being force-fed into a relationship they didn't seek.

We also expect to see more brokers undertaking commercial lending and equity release products. There is a lot of interest in commercial lending. Brokers have stayed away from it historically because it required a different skill set. MIAA is providing education courses on commercial lending and equity release products.

A variation on the above question, what is the biggest risk to the sector?

Externally, that would be a macro-economic shock. This is of course a concern all around the world. I don't see any obvious internal risk occurrence in the foreseeable future.

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Appendix

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Appendix

Table 4: Housing Loans (including Securitisation) Market Share

	Mar-04	Jun-04	Sep-04	Dec-04	Mar-05	Jun-05	Sep-05	Dec-05	Jan-06	Feb-06
ANZ	14.2%	14.3%	14.4%	14.4%	14.4%	14.3%	14.3%	14.2%	14.2%	14.2%
CBA	22.1%	22.2%	22.2%	22.2%	22.3%	22.2%	22.0%	21.9%	21.9%	21.9%
NAB	17.0%	16.8%	16.5%	16.4%	16.6%	16.7%	16.7%	16.6%	16.6%	16.6%
WBC	17.1%	16.8%	16.5%	16.1%	15.8%	15.7%	15.6%	15.5%	15.5%	15.5%
Major Banks	70.5%	70.1%	69.6%	69.1%	69.1%	68.9%	68.6%	68.3%	68.3%	68.2%
ADB	2.2%	2.2%	2.3%	2.3%	2.4%	2.5%	2.5%	2.5%	2.5%	2.5%
BOQ	1.1%	1.1%	1.1%	1.4%	1.4%	1.4%	1.4%	1.4%	1.4%	1.4%
BWA	2.5%	2.5%	2.5%	2.5%	2.5%	2.4%	2.6%	2.7%	2.7%	2.8%
BEN	1.1%	1.2%	1.2%	1.1%	1.1%	1.1%	1.1%	1.1%	1.1%	1.1%
SGB	9.2%	9.2%	9.2%	9.1%	9.1%	9.1%	9.1%	9.1%	9.1%	9.1%
SUN	3.2%	3.3%	3.3%	3.3%	3.3%	3.3%	3.2%	3.2%	3.2%	3.2%
Regional Banks	19.3%	19.5%	19.5%	19.7%	19.7%	19.8%	19.9%	20.0%	20.0%	20.0%
Other	10.3%	10.4%	10.9%	11.2%	11.2%	11.35%	11.57%	11.71%	11.77%	11.77%

Source: APRA.

Table 5: Housing Loans Growth Rates (Annulaised)

	Mar-05	Jun-05	Jul-05	Aug-05	Sep-05	Oct-05	Nov-05	Dec-05	Jan-06	Feb-06
ANZ	17.0%	15.2%	13.8%	12.6%	12.8%	12.5%	12.1%	11.8%	11.6%	11.4%
CBA	16.3%	14.7%	13.6%	13.0%	13.1%	12.6%	12.0%	11.6%	11.3%	11.1%
NAB	12.2%	14.1%	14.4%	14.7%	14.7%	14.9%	14.8%	14.5%	14.0%	13.6%
WBC	7.1%	7.0%	6.9%	7.1%	7.5%	8.1%	8.6%	9.3%	9.8%	10.2%
Average Major Banks	13.1%	12.8%	12.2%	11.9%	12.0%	12.0%	11.9%	11.8%	11.7%	11.6%
ADB	29.6%	28.4%	27.6%	26.7%	25.8%	24.9%	23.2%	21.0%	19.4%	18.1%
BOQ	42.3%	38.3%	38.4%	39.0%	39.5%	40.9%	42.2%	15.2%	15.6%	16.3%
BWA	15.0%	11.8%	15.5%	17.3%	19.0%	21.2%	23.0%	24.3%	25.8%	27.2%
BEN	14.6%	10.7%	8.7%	8.6%	7.9%	7.3%	5.3%	6.1%	6.7%	6.7%
SGB	14.3%	13.4%	12.5%	12.3%	12.2%	12.4%	12.5%	12.7%	12.9%	13.4%
SUN	16.7%	14.1%	9.2%	13.5%	12.5%	12.4%	12.0%	11.4%	10.7%	10.4%
Average Regional Banks	22.1%	19.4%	18.7%	19.6%	19.5%	19.8%	19.7%	15.1%	15.2%	15.3%
Total	15.5%	14.8%	14.1%	13.7%	13.8%	13.5%	13.4%	13.1%	13.0%	13.0%

Source: APRA.

Table 6: Australian Housing Loan Product Pricing

	Variable Rate Loan	Introductory Rate Loan			Fixed Rate Loan		
		Rate	Term	Type	1yr	2yr	3yr
Adelaide Bank	6.50	5.25	6	Variable	6.75	6.75	6.55
ANZ Bank	6.72	6.00	12	Variable	6.85	6.79	6.65
Aussie Home Loans	6.74	n/a	n/a	n/a	6.78	6.78	6.79
Bank of Queensland	6.74	n/a	n/a	n/a	6.59	6.59	6.59
BankWest	6.65	6.32	12	Variable	6.75	6.75	6.75
Citibank	6.62	6.25	12	Variable	6.85	6.55	6.59
Commonwealth Bank	6.81	5.99	12	Variable	6.85	6.79	6.65
Homeloans Ltd	6.76	6.60	12	Variable	7.15	7.15	7.11
HomeSide Lending	7.02	6.09	12	Fixed	6.85	6.79	6.65
ING Bank	6.70	6.24	12	Variable	6.65	6.65	6.65
Macquarie Bank	6.80	n/a	n/a	n/a	6.89	6.89	6.85
Mortgage House	6.82	n/a	n/a	n/a	7.10	7.30	7.30
National Australia Bank	6.62	5.99	12	Variable	6.85	6.79	6.62
RAMS Home Loans	6.69	6.52	12	Variable	n/a	7.00	7.05
St. George Bank	6.74	6.14	12	Variable	6.85	6.85	6.59
Suncorp	6.74	5.99	12	Fixed	6.85	6.79	6.55
Westpac Banking Corporation	6.74	5.99	12	Fixed	6.85	6.79	6.65
Wizard Home Loans	5.71	n/a	n/a	n/a	n/a	6.74	6.69

Source: bankchoice.com.

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