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## Banks to Suffer When Housing Market Cracks

ANZ has a \$145bn mortgage book. We're told that if house prices fall 20%, interest rates hit 13.4% and the unemployment rate skyrockets to 8.1%, its models suggest it will lose a grand total of \$201m. That's 0.144% of the book.

QBE owns Australia's largest mortgage insurer, PMI. It claims that if mortgage arrears increase 15-fold, its provisions will still be 'adequate' and the business will still be highly profitable.

I've been scratching my head about this apparent conundrum for a number of years. There's clearly risk involved if house prices fall – almost 20% of ANZ's loan book by value has a loan-to-value ratio in excess of 80%. But if the banks aren't wearing the risk, and the mortgage insurers aren't wearing the risk, someone tell me who's on the hook?

I'd love to get ANZ's Mick Smith and QBE's Frank O'Halloran in a room and ask them. Absent that unlikely scenario, there's perhaps a clue in NAB's half-year results.

'An increase [in retail provisions] of \$142 million during the half to March 2009 represents a decline in the quality of housing and credit card loans. In addition, this increase includes a management overlay raised to cover loans ... *where claims may not be met by the lender's mortgage insurance providers*' [my emphasis].

Mortgage insurers don't analyse every loan they insure. In fact, they hardly check any at all. All they do is provide the lender with a bunch of loan criteria under which they are prepared to provide insurance. It's the bank's job to make sure the loans qualify. Now that mortgage insurance claims are on the rise – ANZ's number of possessions almost doubled in the past 12 months – the insurers are rejecting claims on the basis that some of the loans should never have qualified.

I've no idea how many claims are likely to be refuted or who is ultimately going to end up wearing the pain. But I do know that, thanks to crashes in many parts of the developed world, Australia stands alone as the most overpriced housing market in the world. And propping up the market with dumb incentives like the first homebuyer's grant is only making the problem worse.

Both the insurers and the banks are going to suffer severely when it comes unstuck.