Deloitte.

The Australian Mortgage Report 2014

The digital & data revolution

9th Deloitte Australian Mortgage Report

Deloitte Australian Mortgage Report 2014
The digital & data revolution

The $1.3 trillion Australian mortgage market is on the cusp of exciting change led by a digital and data revolution. In this report, the Deloitte Australian Residential Lending Industry Roundtable considered current trends in home loans, and in particular, looked forward to the driving forces of change over the next three years to 2017.

The roundtable (comprising representatives of Australia's major, non-major and non-bank lenders together with the heads of mortgage broker groups), discussed the nature of the Australian mortgage marketplace and the impact of the impending consumer-led digital revolution on mortgages. It explored the structural challenges which the Financial Systems Inquiry has the opportunity to address, such as the nexus between mortgages and superannuation, and the influence of funding and regulation on competition and innovation in the mortgage marketplace.

How do we get the balance of these challenges right going forward?

Our panel of industry experts have contributed to this document and their perspectives are detailed across five main topic areas.

We trust you will find the Australian Mortgage Report 2014 both informative and thought provoking. Deloitte looks forward to discussing this research with you as we work together to leverage the opportunities in 2014.

James Hickey
Banking Partner
Deloitte

Graham Mott
Banking Partner
Deloitte

Contents

Executive summary

As the mortgage lending market surges into 2014, it is clear that the year ahead will be different from what we have experienced since the onset of the Global Financial Crisis. Deloitte Banking Partner James Hickey considers how the pace of change will continue as lenders seek to adapt to the challenges and opportunities through to 2017.

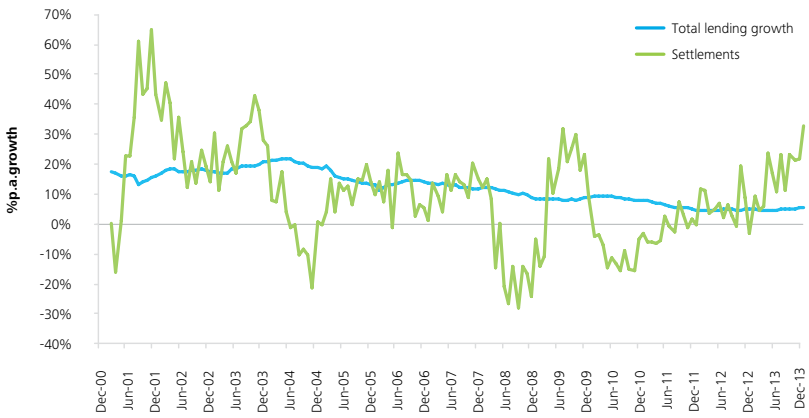


Figure 1: Source: ABS, Deloitte Actuaries & Consultants 2014

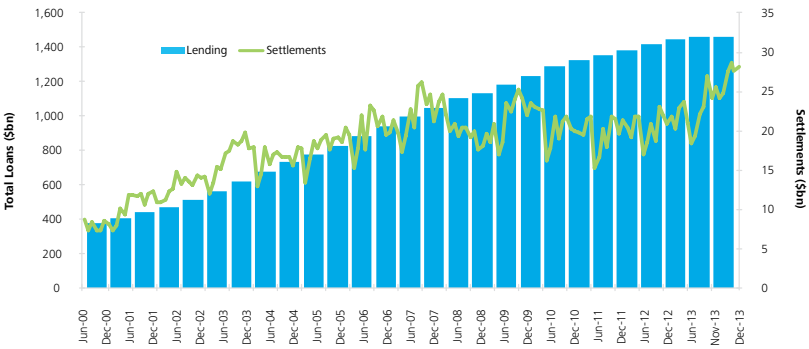


Figure 2: Source: ABS, Deloitte Actuaries & Consultants 2014

The here and now: 2014

The news in 2014 is that mortgage settlement growth is back and competition will intensify.

With confidence amongst borrowers high, investors coming back into the market, and funding pressures eased, major banks, non-major banks, and the returning non-bank lenders are all out for a slice of the market. The tailwinds of growth were evident as 2013 came to a close, with settlement growth of 20% driving a record number of housing commitment applications across the market.

This resulted in settlements on a monthly basis exceeding $28 billion across Australia. This is the highest single month of settlements on record, and a clear jump since the onset of the GFC which had monthly figures struggling to reach $20 billion.

While growth in settlements measures the rate of 'new' flow in the market, the overall total mortgage market of outstanding loans was more subdued. That is, the $1.3 trillion total market for outstanding loans had only modest growth of 5% throughout 2013. This has a number of consequences on the dynamics in the market.

- It implies the majority of 'new' settlements coming into the market are from existing borrowers (owner occupiers and investors). It is not reflecting first home buyers coming into the market.
- Given their weighting to the overall system, the major banks are facing the pressure of their portfolios only growing at 5%, but having to compete for 'new' settlements with increased discounts and commission bonuses to brokers. This will continue to place pressure on interest margins for the major banks.
- Non-major lenders, and non-bank lenders that have access to funding, will be able to compete more aggressively with major banks to gain market share in 2014.

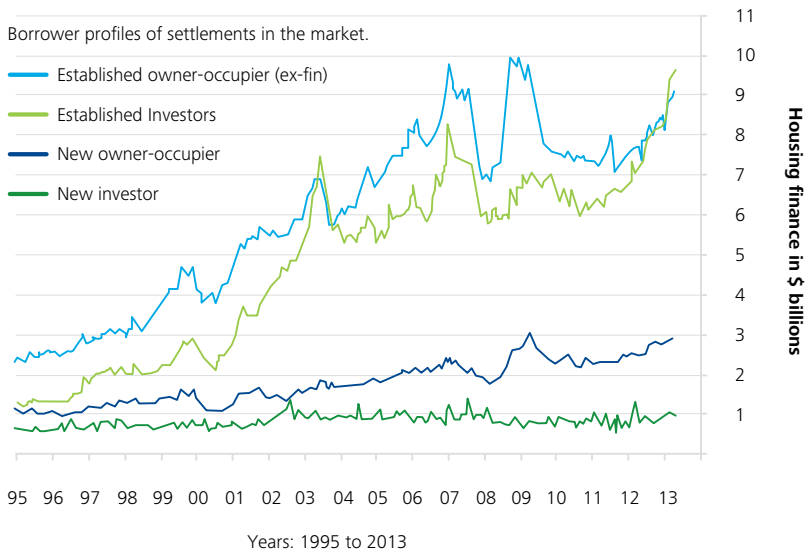


Figure 3: Source: ABS, Deloitte Actuaries & Consultants 2014

Figure 3 highlights the borrower profile of settlements in the marketplace. As can be seen most of the growth in settlement volume through 2013 was driven by existing owner-occupiers and existing-investors, at the expense of first home buyers.

The pathway to 2017

The market we are facing in 2014 in many ways highlights the long term structural challenge of mortgages in Australia – how to produce better equity in the system across existing and new borrowers, and across major and non-major lenders.

Two important factors will influence mortgages over the foreseeable future: one market and policy led, the other consumer led.

1. **The Financial System Inquiry:** this has the opportunity to define and improve the structural makeup of the mortgage lending market. It will need to consider the balance that is desired between competition and regulatory stability, how best to encourage innovation while still protecting consumers, and how to ensure Australia uses the advantages it has to support its mortgage lending market – especially the superannuation system's interaction with mortgage funding.

While the Inquiry will explore many areas of financial services, those with particular importance to the mortgage sector will be:

- **Integration:** How the superannuation system and the mortgage lending sector can better integrate and support each other. These are the two largest engines in Australian financial services, with superannuation, a $1.5 trillion sector, and mortgage lending, a $1.3 trillion sector. This opportunity for greater interaction needs to be explored at both a macro (system wide) and micro (individual household) level

- **Housing affordability:** it remains a challenge for first home buyers to enter the market. At the other end of the age spectrum, there is a growing longevity challenge with many retirees living the traditional 'asset rich, cash poor' lifestyle, and having little incentive (in many cases disincentives) to downsize from the family home. The Inquiry represents an opportunity to consider the longer term balance of demand and supply of property, and its facilitation through a generational shift

- **Regulation** (and competition): especially the 'level playing field', or potential lack thereof, which regulation in the mortgage sector can create. Our regulatory framework undoubtedly assisted in the stability of our system during the GFC, however at what pace does it need to evolve and for which lenders is the cost more pronounced (and the impact on competition). All need to be addressed

- **Competition and technology:** future new competitors in the mortgage lending market will likely leverage significantly from technology-led innovations. How such forms of competition can emerge and the framework to support this market-led evolution should be an important agenda item for the Inquiry.

2. **The Digital and Data Revolution:** there is already a digital and technology revolution in payments and 'real time' customer access in the banking sector. It will not be long before such customer-led digital needs have a pronounced impact on the way mortgages are offered in Australia.

   The challenge for lenders is interpreting what 'digital' means for customers when it comes to mortgages. Is it front end access and querying? Is it online lodgements and end-to-end fulfilment of the mortgage? Is it tablet and mobile enabled real time account flexibility or any other myriad of consumer mortgage needs? And from a lender's perspective, is digital only about dealing with the customer? Or is it equally about digitising back office functions and processes to improve efficiencies?

One thing is clear, digital and data will be the main game for mortgages over the next three years. For lenders, brokers and consumers, the digital and data revolution will produce significant change in how we think of the traditional mortgage in the future

Together with digital, the capture and access of data through all forms of interaction a customer has with vendors, is rapidly growing. However, having access to the data, and being able to use the data in ways which the customer values, are two different propositions. Those lenders and brokers that can successfully marry data capture, with proactive and valuable interactions with customers, will surge ahead. Customers expect digital, and they also expect that our banks know us and our preferences.

While the mortgage origination process is seeing some of the pieces come together for data and digital, with positive credit scoring and electronic conveyancing taking shape in 2014, this is but the tip of the iceberg for data and digital. The big banks have a clear advantage at this point. They have the depth of customer data, and they have the investment spend for digital innovation. Others will have to make smart choices about how to position themselves to be ready for the future opportunities.

Deloitte Australian Mortgage Report 2014 Roundtable

Deloitte Australian Mortgage Report 2014 roundtable attendees

The Australian lending roundtable was chaired by Deloitte Financial Services partners James Hickey and Graham Mott

Industry attendees were:

Back/middle row from the left:

- **Deloitte:** Graham Mott, Partner Financial Services
- **Macquarie Bank:** Frank Ganis, Head of Intermediary Banking
- **Deloitte:** James Hickey, Partner Financial Services
- **Deloitte Digital:** Katherine Milesi, Partner
- **CBA:** Clive Van Horen, Head of Mortgages
- **Deloitte:** Chris Wilson, Partner Financial Services
- **UBank:** Rob Plow, Director Operations
- **Mortgage Choice:** Michael Russell, CEO
- **ANZ:** Brad Gravell, General Manager Mortgages & Deposits
- **Citi:** Vibha Coburn, Managing Director Retail Distribution

Front row from the left:

- **Yellow Brick Road:** Matt Lawler, CEO
- **Pepper Group:** Patrick Tuttle Co-Group, CEO
- **Deloitte:** Louise Denver, Corporate Affairs & Communications
- **Nab Broker:** Steve Kane, General Manager
- **ING Direct:** Lisa Claes, Executive Director Distribution.

The $1.3 trillion mortgage market in Australia will remain key to delivering earnings performance for most lenders

Innovation

In this section the roundtable discussed how Australia's mortgage market is innovative compared with the rest of the world. While we often look offshore, there is much that is 'best of breed' globally right here in Australia.

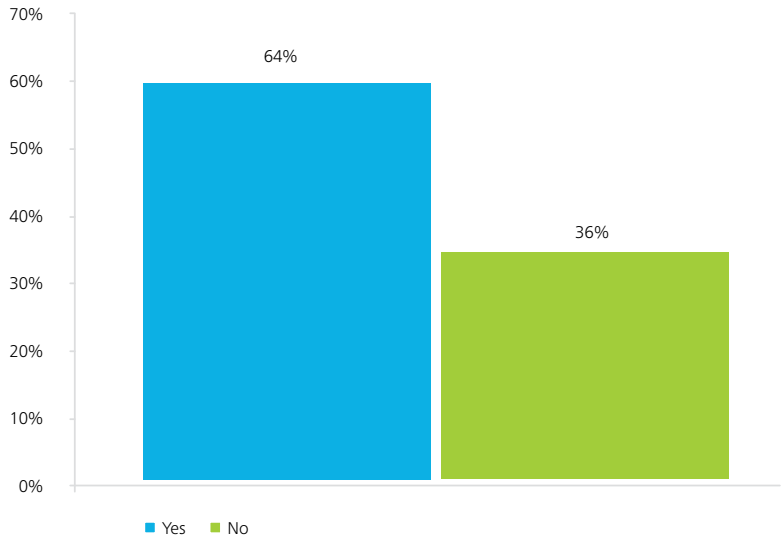


Figure 4: Source: Deloitte Actuaries & Consultants 2014

Is Australia innovative in mortgages compared to the global market?

James Hickey (Deloitte)
The majority of you felt that Australia was innovative when it comes to mortgages compared with the global market. What aspects do you consider lead Australia to being innovative in mortgages?

Vibha Coburn (Citi)
My experience is mostly in Asia and Australia, with some view of the US market. Because the mortgage market is such an important asset pool in Australia in terms of worth – currently at around $1.3 trillion – we just have had to be creative about it.

Innovations like the line of credit which Australian lenders offered years ago and the mortgage redraw function are examples of what we consider as standard features. You don't get that in the US and you definitely don't get that in Asia.

Compared to the US, Australia is very innovative. The US regulators are quite fascinated by our market, our combination of product types and the flexibility we offer to our customers.

Vibha Coburn (Citi)

Frank Ganis (Macquarie)
Our products are innovative in Australia because of competition and the way our banks have developed the market over the years. When you look at markets in North America, funding of mortgages may be assisted by government initiatives. For example, the two largest US mortgage funders, Fannie Mae and Freddie Mac, were previously predominantly government owned, and the Canadian market is supported by government-owned and sponsored participants.

Australia on the other hand is essentially market-driven, competitive and, as a result, innovative. We have looked at exporting this innovative and competitive culture overseas, but in reality it is challenging to influence or change longstanding cultural behaviour of distributors and borrowers in different jurisdictions.

Matt Lawler (Yellow Brick Road)
Innovation is a dichotomy. It suggests that you are edgy. In a way, Australian innovation has been smart innovation. But a lot of other countries, particularly North America, went right to the edge. They were so edgy, they tipped over. Australia on the other hand is very innovative in a conservative or risk-based way, which is why we didn't have the problems of some of the other countries during the GFC.

James Hickey (Deloitte)
Pat, Pepper Home Loans has been expanding and taking Australian innovation offshore. Is Australia's mortgage landscape more favourably positioned for innovation that others overseas that you have been seeing?

Patrick Tuttle (Pepper)
Australia is by definition both unique and a more innovative specialist mortgage market than the rest of the world. The specialist market began in the UK in the late 90s. However post crisis, all of the UK's innovative mortgage providers, specialist and non-conforming lenders have been effectively wiped out.

The only area of specialism in the UK mortgage market now is around 'Buy-to-Let' lending. In terms of innovation around credit underwriting here, we are in a unique position. I think the loan and credit features that Australia takes for granted on a standard residential mortgage are much broader than in Europe.

From a consumer perspective, where is improvement most required in mortgages?

James Hickey (Deloitte)
A number of you, as heads of mortgage lending and broker groups, will be charged with this very task. Consumers are increasingly demanding more from almost all products and services, mortgages included. Understanding where and how will be both the challenge and opportunity for the market.

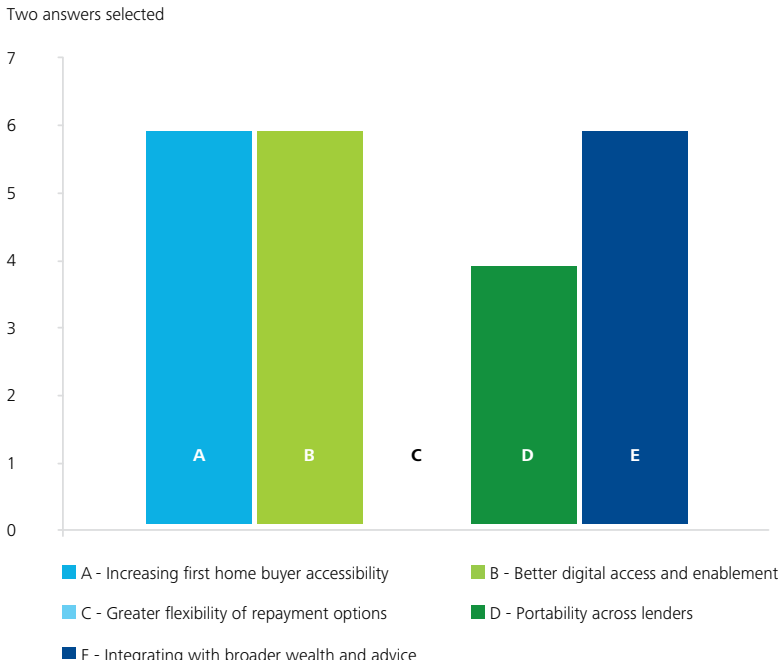


Figure 5: Source: Deloitte Actuaries & Consultants 2014

Brad Gravell (ANZ)
I chose 'better digital access and enablement' as a key area for improvement. I have an eight year old and watching him play online games with his cousins, seeing their digital dexterity, shows me that whether in five, ten or fifteen years from now, the view that mortgages are complex and need to be dealt with by people rather than online, won't hold true for too much longer.

Whether 'assisted self-serve', or 'complete self-serve', the evolution of the digital world will be one of the primary forces in our business. If we don't keep up, we will be left behind.

Clive Van Horen (CBA)
I absolutely agree. If I had only one vote it would have been for digital. And if there had been another vote that wasn't there, it would be for simplicity; simplicity in the process and enabling that for the customer.

The whole digital trend is huge. It's not just the demographics of young people who are using digital - but it is people across the demographic spectrum. In our research, statistics are that more than 90% of people start the process of researching to buy a property, online. Consumers are doing it online already whether we like it or not.

Making the process simpler end-to-end for them, I think that's where the game is.

James Hickey (Deloitte)
What key impediments are there in meeting the digital needs of consumers in the mortgage sector?

Clive Van Horen (CBA)
The challenge is very different for all the different businesses represented around this table. From the broking side, the challenge is how do you embrace this digital world when you still have a very strong face-to-face proposition that is a key part of what a broker offers? Similarly in the bank's own proprietary channels – how do you embrace digital along the way? I don't think there is any structural impediment. It's an investment challenge.

Katherine Milesi (Deloitte) and Clive Van Horen (CBA)

Lisa Claes (ING Direct)
If I may be controversial about it, I think one of the impediments is complacency. The industry hasn't needed to embrace digital because of fat margins and credit growth. It is the lean cost model that drives digital innovation.

Vibha Coburn (Citi)
I like the idea of 'assisted'. People are searching online to understand all the features offered by various providers. They now come in armed with considered queries, this includes first home buyers. Our clients are more knowledgeable now than they were five to ten years ago. I think consumers will lean more and more towards 'assisted purchase' and 'assisted home loans' in the coming years.

Katherine Milesi (Deloitte)
This is an important point. If you look at our retail industry, it was complacent for far too long. We now have international retailers coming in with combinations of online and bricks and mortar stores. Our retailers are struggling and it's not just a retail downturn that they are suffering from. It was their lack of vision five years ago to realise that digital would be so important.

To your point Clive a customer needs simplicity – at all stages – at the research, purchase, post-purchase and service lifecycle stages. But from a corporate point of view, it's not so simple, because digital is not just a website accessed from a laptop. Mobile has exploded.

Clive Van Horen (CBA)
I think it's a huge challenge. And I don't say for one second that we've got it right. One of the big challenges we see is cross-channel integration. Customers are going to do what they want to do; whether they start with a broker or online, or in a branch or a call centre. We have lots of channels. It is how we integrate all those channels and make it easy for customers to navigate their way across them. That's the organisational challenge. It is really hard to do and becomes an execution challenge.

> There are 23 million Australians, and we have 32 million mobile devices, which will grow to 100 million in five years' time. So digital is not just about laptop, it's about mobile – smartphones, tablets and phablets – as well as social media

Michael Russell (Mortgage Choice)
When using the term digital, we need to be very specific regarding its context. This is because in my view it is often misused when talking about mortgage fulfilment. To this end, we are many years away from being able to even conceive of end-to-end digital fulfilment. Online lodgement to approval is still not delivering the sort of immediate conditional approvals we had all hoped it would. The lenders in the room know that this percentage remains very low when considering the millions of dollars we have all invested in our digital technologies.

Vibha Coburn (Citi)
The question of digital fulfilment and online sales looks at mortgages from the industry's perspective. However, if the question was "Does the consumer want this?" then the answer appears to be "Yes".

From the industry's perspective, the delivery challenge exists in terms of simplicity of process and that's something that will continue to evolve with technology.

Katherine Milesi (Deloitte)
If we look at the large retailers, some CEOs may say that only 3% of their sales go through the online channel therefore it can't be that important. But in fact 80% of apparel sales are influenced by digital. So it's not just the fulfilment, it's the research that informs the purchase and encourages a customer to go into a store. This is influenced heavily by digital and social marketing.

Lisa Claes (ING Direct)
Better digital enablement is about integrating digital into the value proposition. The research is potent when it comes to onboarding in financial services.

At the front end it's about integrating digital and third party. No-one loves third party more than I do! We get lots of requests from brokers as to how to present digitally in a better way. So the online and brokers do and can co-exist quite nicely together. But equally when I think about digital, I think about digitising operations in the back office. This is where the huge game is for lenders.

Michael Russell (Mortgage Choice)
We would love to give our clients a better experience lodging online. But the percentage of lodgement to conditional approval is still not giving them that great experience. It remains a big challenge.

When I think about digital, I think about digitising operations in the back office. This is where the huge game is for lenders

Lisa Claes ING

Rob Plow (UBank)
We need to be careful when we talk about the mortgage market as one market. It is in fact a number of different markets based on the customer's prior experience and confidence.

Each will have different digital needs, from research to complete self-service. As an industry we need to respond to what the consumer wants.

Rob Plow (UBank)

Investors
As an example, if you have investors with five or six investment properties, they know the mortgage borrowing process and requirements. Therefore they are focussed on price, as that is what maximises their gains.

First home buyers
First Home Buyers, on the other hand, don't know the process and will also have a significant emotional attachment to the property they want – their fear is of losing out on the purchase. The digital experience may not be able to satisfy their requirements – they want more hand-holding and assurance during the process.

Therefore from a business perspective we need to understand: 'Which customer segment is best suited to deliver?' 'How well can we service that market?' 'What is the consumer expectation?' and 'Can we deliver to that expectation?'

Due to these diverse needs of the customers it is not possible for a one fit solution – trying to be everything to everybody is never going to work

Customer enablement – a win:win

Deloitte Partner **Arturo Mauleon** considers how innovations in digital and data will allow banks to better interact with their mortgage customers while delivering operational efficiencies and assisting lenders to better manage risk and decision making.

Enable the customer

Know your customer: By understanding who the customer is – not just their financial requirements as a First Home Buyer, refinancer or an investor – but their preferences and profiles, the mortgage sector can better enable the customer. Advances in analytics are helping the sector create innovative and detailed personas and profiles, which help to drive personalisation.

> Digital identities: Social information from sites like Facebook and Linked In can be used to develop a profile and inform a persona. Is the archetype a risk taker for instance? What are their preferences, their experiences, and interests?

Facilitate customer interactions: Innovative analytics will make the difference between merely capturing data and understanding it. For instance, geospatial mapping – currently used to good effect in the insurance and wealth sectors – can deliver more enriched information to build a better picture of the customer. Such mapping also means it will be possible to build a series of personas from similar geographies with similar lifestyles that can inform the bank and enable the customer to select the persona that best reflects them.

Build out the mobile channels: Banks both domestically and globally are rapidly exploring how they can better enable the customer experience through mobile technologies. There are mortgage calculators that leverage touch screen and sliders to enable the customer to get information when and how they want it. You can make it easier for customers in an advice-led model when you enable the experience across all the technologies that customers expect to use.

Understand moments that matter: To create a personalised experience it is important to know, for instance, which customers require more hand-holding and when to do that. By being cognisant of what matters to the customer, you can leverage the digital process, and when required, engage other channels so customers can easily select what's right for them. Even the emergence of 'wearable devices' may in time present opportunities to better understand these 'moments that matter'.

Enable the lender

It is a Win-Win: Customer experience and efficiency are no longer at odds. Innovations in technology are helping banks drive improvements in customer experience and enabling them to achieve substantial benefits from improved conversion, ability to cross sell and lower cost to serve. Leveraging co-design is allowing banks to trial and iterate offerings quickly, reducing the cost of failed innovations and increasing the likelihood that customers will adopt and engage with the bank.

Smart compliance and security: New technologies are helping banks reduce operational and compliance costs whilst enabling a straight through process. In the originations process for example, banks are now able to electronically tap government data sources to verify customers, upload electronic capture of documents, and leverage unstructured data, allowing banks to further automate the process reducing manual intervention and costs. Importantly, this shift is enabling banks to free banker's time away from administrative and transactional tasks, and redirect it towards the customer and value-added advice.

Better decision making: Analytics and visualisation tools are enabling shifts in the use of data to facilitate proactive and accurate decision making. In addition, analytics coupled with Digital Identities provide the next frontier of information that a financial institution can leverage, with some banks already exploring how they can be used as part of the credit decisioning process and reducing the risk profile of the bank. This can also be used to help identify and reduce fraud.

Social business: At several banks, marketing and public relations have established listening posts to track consumer sentiment in the social sphere. And customer contact centres are moving beyond passive monitoring of social channels to actively engage with personalised outreach, promotions, and product support. This is enabling banks to quickly refine their product, service, and experience.

Integrated organisation: Sales and customer service divisions are already integrating customer contacts across channels, and connecting with product development, service and fulfilment teams. Technology is enabling channels to come together enabling a more integrated and seamless experience for the customer.

While this is progress, it is only the beginning of what is possible

Innovation (Cont.)

From a lender's perspective, where is most innovation required in mortgages?

James Hickey (Deloitte)
How do lenders, many of which are multi-service organisations, innovate and meet the needs of consumers within the institutional frameworks of such organisations?

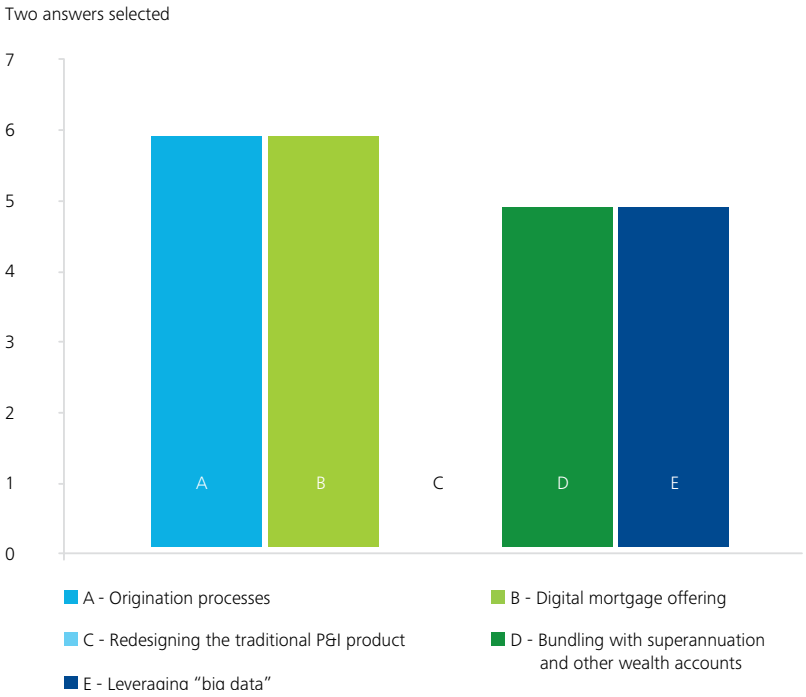


Figure 6: Source: Deloitte Actuaries & Consultants 2014

Matt Lawler (Yellow Brick Road)
I think the trend in the market, and in financial services as an industry, is actually the aggregation of many singular and historically separate industries. It used to be banking, insurance, funds management, and superannuation. Now they have all come together as one industry and are seen as financial services.

Aggregation and the world through the customers' eyes

The more we look through the customers' eyes, the more we know it is the customer's needs we are serving. If we approach customers from several different perspectives, they are actually more financially disorganised than they were before they saw us!

Matt Lawler (Yellow Brick Road)

So I think the objective of assisting the customer to be financially organised leads to innovation that starts with advice

1. **Aggregation of information:** Customers need innovation first and foremost around the aggregation of their information across all of their financial services products. This in itself requires continuous innovation in the background.

   So all of a sudden you have this intersection of different industries, on different systems, coming together. They all have to report back to the client on the same thing. I think we should continue to stretch that to see it go further.

2. **Linking home ownership and super:** Possibly an innovation for the future, when we start to look at how hard it is for young people to get a home, is to try and work out how we take this big superannuation asset and allow people to see them as two linked things not as completely separate things. I know this has been on the table before, but it's becoming a bigger and bigger issue for young people to find the 'must-have' deposit.

3. **Funding:** I think the other big innovation could be how we use this big superannuation asset to fund mortgages, to be a funding mechanism so we don't have to go overseas and be subject to those risks. These are the sort of intersections that I see which starts from the customer's point of view and works backwards to see how we can manage the assets in a way that is more beneficial for all stakeholders.

Vibha Coburn (Citi)
In Singapore, they already have such a scheme. It is administered through the government Central Provident Fund (CPF) which is equivalent to our Superannuation fund. Everyone uses their CPF accounts for their mortgage deposits. People make monthly contributions into this fund, however, their monthly repayments also are covered in part or fully from this fund. Under a formula they contribute a certain percentage of income (16% to 20% with a cap of S$5,000 per month), so that when the house is sold, the funds go back to their superannuation fund. The fund is used for their primary owner-occupied home. 81% of households in Singapore live in public housing and this scheme works quite well for the younger generation too.

> Maybe we should consider a scheme here where you contribute a certain percentage into a fund that recognises that people's incomes grow after 10-15 years of working, and have some sort of cap on that?

Matt Lawler (Yellow Brick Road)
In this way the funds are not lost forever. They are still in the system. It's just been invested in a different asset (ie property) which is not a bad performing asset historically.

Steve Kane (NAB Broker)
There are two aspects. One is the funding of the whole channel, the whole mortgage business and using super funds and this asset class as part of the investment strategy. The other is the huge wealth transference going on.

A lot of people are retiring and have a massive amount of wealth sitting in super. Parents now have the ability to use their super in an efficient way to assist their children get into property.

There has been some commentary that at auctions, it is actually Mums and Dads investing in units for their children for 10 to 15 years' time. This links up to the first question about integrating broader wealth and advice. There is no doubt that there is a lot of convergence going on. It may not have gone quite at the pace everyone expected, but it is happening.

Steve Kane (NAB)

The Singapore CPF scheme

Singapore has a compulsory retirement scheme, the Central Provident Fund (CPF). This scheme allows its members to use a portion of their retirement savings to meet the deposit and the monthly instalments on a loan on a Singapore flat.

Prior to retirement, a working CPF member will contribute a portion of their wages to the CPF. The level of contribution to the scheme is at a rate of 36% of wage for workers aged 50 or less, with contribution rates decreasing thereafter until retirement. Contributions are shared between the member and their employer. These contributions are primarily intended for retirement and healthcare purposes.

There are limits on the amount of savings a CPF member can use for housing. Under most circumstances, the CPF scheme will require members to first set aside a specified amount for retirement before allowing them to use their savings for housing. Nevertheless, those who spend too much on their home may end up with an inadequate income in retirement. Unlike Australia, there is no age pension to fall back on in Singapore.

In addition, CPF is an annuity scheme whereby members are required to purchase an annuity with their accumulated retirement savings at retirement. The purchased annuity will provide members a monthly pension until death, thereby protecting retirees from longevity risk. This is unlike the Australian system where majority of retirees withdraw their super in a lump sum form which consequently creates greater exposure of longevity risk for the individual retiree.

So while it may be interesting to consider the potential to use accumulated retirement savings for a housing deposit, there are many other aspects of the design (especially potential retirement adequacy impacts) that would need to be considered.

Competition

The consensus is that the current balance of power between competition and stability is about right, but there needs to be a deliberate shift towards more competition over the next three years. New competition may well be from new online channel lenders (not necessarily banks) such as supermarkets, telecommunication companies and unexpected sources such as data aggregators.

Where will the growth opportunity be over the next three years?

Graham Mott (Deloitte):
I notice from the responses that opportunities over the next three years will remain with refinancers and upgraders as well as investors. The growth in SMSF lending is moving ahead, but not as much as all others. Mike how do you see the market?

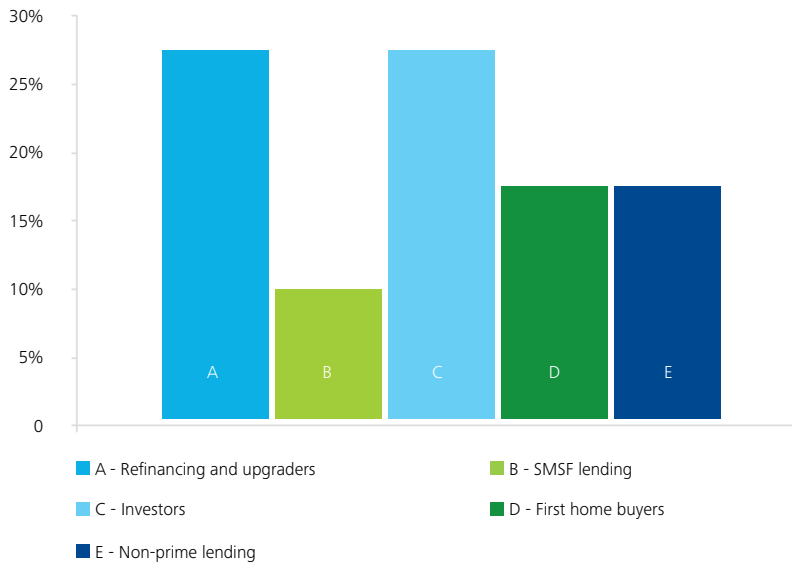


Figure 7: Source: Deloitte Actuaries & Consultants 2014

Michael Russell (Mortgage Choice)
I voted for refinancers and upgraders and investors. Certainly Mortgage Choice has a strong desire to write more SMSF lending, but the real issue for our franchisees is the up-skilling required to give them the knowledge and confidence to advise on this new lending product.

Refinancers and upgraders – investors returning to property

I see the market over the next three years being dominated by refinancers and upgraders, particularly upgraders, as consumer confidence has returned to the market place. We are seeing a lot more lending to people moving to better homes.

For investors, with the ASX at its highest level for many years, good yields are becoming quite scarce, so I think a lot of investors will return to property.

James Hickey (Deloitte)
Is that the right mix in the next 3 to 5 years – that refinancers and investors will have a greater share of the mortgage market than first home buyers?

Steve Kane (NAB Broker)
It has always been so. It is just accentuated presently with a significant dip in first home buyers in recent times.

Michael Russell (Mortgage Choice)
Our own data in terms of the first home buyer mix is very consistent and is where it has always been. So it concerns me that with the removal of the FHOG (First Home Owner Grant) from established properties in most states and territories, that we may be under-reporting first home buyers to the Australian Bureau of Statistics.

Additionally, we are not including in the first home buyer count those genuine first home buyers who are electing to buy an investment property in lieu of a property for owner occupation. This is a growing trend amongst discerning first home buyers, yet their presence as first home buyers is not being accurately recorded.

Brad Gravell (ANZ)
You are right, because the returns provided don't necessarily give a scientific specific data point for First Home Buyers. They are using proxies like LVRs, as well as grants, and other surveys in the market to form their conclusions. What makes it worse is that in the last couple of years, the movement of activity from other segments is also clouding the data. So you are right the data on first buyers is not necessarily absolutely correct, but it may well be so relatively.

Steve Kane (NAB Broker)
On the credit side of the business, affordability is becoming more difficult for the first home buyer.

The need to have a 5-10% deposit combined with the propensity of lenders to write 90/95% plus LVR transactions, shows that the banks' risk appetite may have changed, as well as the quality of the data.

Frank Ganis (Macquarie)
Given that lending criteria has tightened post 2008, it is now much harder for borrowers to access greater than 90% funding, particularly for prospective First Home Owners who are also bidding against other established purchasers/owners.

The challenge though, is capturing the first home owner data, as there are trigger points when you capture that data and when you fund the loan. But without the requirement for the FHOG, it is more difficult.

Michael Russell (Mortgage Choice)
In the last 30 years there's also been a fundamental shift in the expectations of First Home Buyers who now want and expect to buy in either the area they were brought up, or in close proximity to their place of work. First Home Buyers now are buying a far greater percentage of established property as opposed to new dwellings on the fringe.

Louise Denver (left) Deloitte, Frank Ganis (Macquarie) Katherine Milesi (Deloitte)

First home buyers

While the mortgage market is showing strong growth in settlements, with more than 20% annualised growth leading into 2014, this masks the fact that most of this activity is from existing borrowers. James Hickey looks at what can be done to ease the process for First Home Buyers.

The stark reality is that it remains very difficult for First Home Buyers to enter the Australian property market. Recent figures show that the proportion of First Home Buyers has fallen to its lowest level in more than 10 years, sitting at barely over 12% of all new loans issued as we move further into 2014.

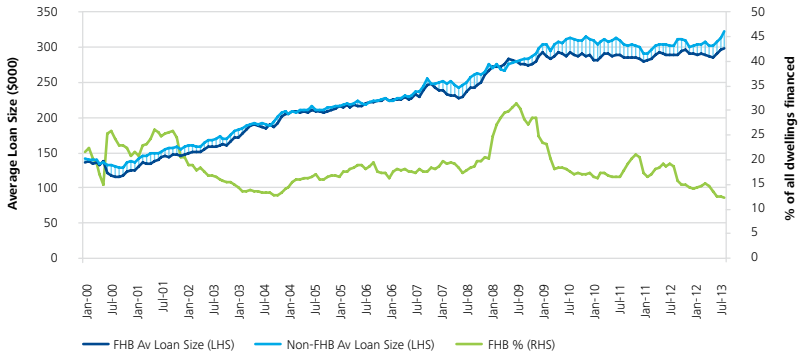


Figure 8: Source: ABS & Deloitte Actuaries & Consultants 2014

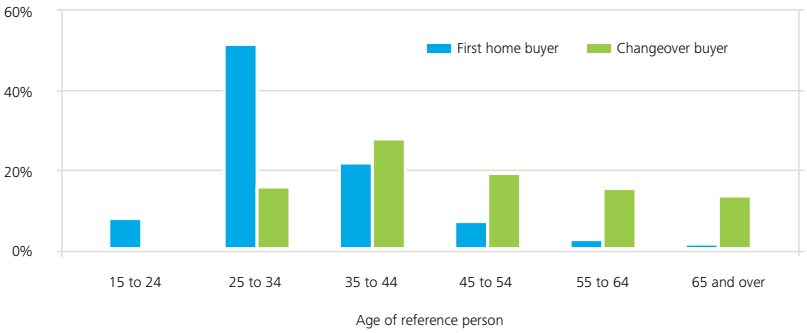


Figure 9: Source: ABS, Deloitte Actuaries & Consultants 2014

However, the average loan size taken on by First Home Buyers is not dissimilar to that of non-first home buyers (with each around $300,000). The difference is that non-first home buyers have the benefit of existing equity accumulated in their current property. This, combined with often better income serviceability power, make it a relatively easier purchase for non-first home buyers. Data about the age profile of first home buyers and non-first home buyers supports this. It is interesting to note that not all first home buyers are under the age of 35. More than one-quarter are over 35 years of age, with a stronger income base to leverage.

So what can be done to improve the plight for First Home Buyers? Do lenders need to design a product solution? Do governments need to offer more grants? Do housing bodies need to build more affordable housing? Do the tax benefits favouring investors (with negative gearing) need to be amended? Or does the burden of heavy upfront stamp duty need to be rebalanced with other taxes?

The reality is that the solution will likely require a whole range of incremental actions.

Perhaps the most important action will be for First Home Buyers to set realistic expectations about entering the property market. If the expectation is to replicate what 'Mum and Dad' have with the family house, this may be a step too far initially. It would be more prudent to focus on more affordable units, build up equity, use this to move up the property ladder and upgrade over time. It's not easy for First Home Buyers, but there are steps that can ease the process.

Competition (Cont.)

How would you rate the current balance of power between competition and stability?

Where does the future balance of power between competition and stability need to be?

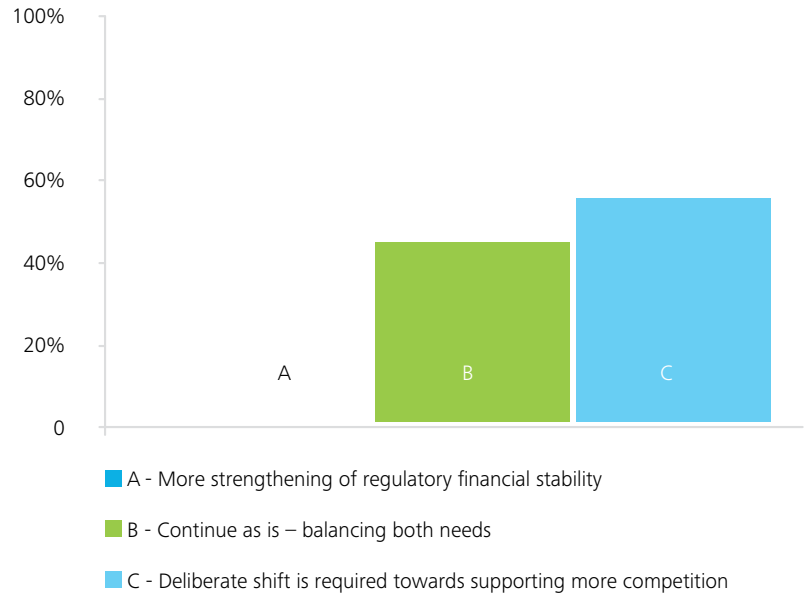


Figure 11: Source: Deloitte Actuaries & Consultants 2014

How would you rate the current balance of power between competition and stability? And where does the future balance of power need to be?

James Hickey (Deloitte)
The majority of the roundtable thinks the current balance of power between competition and stability is about right, but that if anything, over the next three years, there needs to be a deliberate shift towards more competition.

Patrick Tuttle (Pepper)
I think the level of competition is about right. I hope the Financial Systems Inquiry doesn't turn into a 'bank bashing' exercise as that would waste everyone's time. Frankly the non-banks benefit from the major banks' strength as much as anyone else. As a non-bank lender, Pepper relies on wholesale funding from the major banks. They also help us distribute our bonds in the debt capital markets.

Patrick Tuttle (Pepper Group)

Frankly the non-banks benefit from the major banks' strength as much as anyone else

Patrick Tuttle ,Pepper Group

Securitisation and funding

I want to see securitisation as a huge topic in the Financial Systems Inquiry due to its importance to the regional banks, non-banks and even the larger banks as a source of funding diversification, and hence a catalyst for a more level playing field. More funders will be able to participate in the Australian mortgage market and competition will be facilitated as a result of a more vibrant securitisation market.

Securitisation has been much maligned because of the issues which emerged in the US sub-prime market, however there is increasing global recognition of securitisation as an important and legitimate funding tool for residential mortgage lending.

In a market like Ireland where Pepper operates a substantial loan servicing operation, unless securitisation gets going again, or there is funding from other sources, there will be no credit growth because the domestic pillar banks are frozen and all the foreign banks are pulling out of the market.

So, unless there's funding from sources like securitisation, the banks won't be able to grow lending and support the household and SME sectors. If you focus on securitisation as a way of levelling the playing field I think it's a good start. It certainly facilitates lending competition in the Australian market, particularly for smaller banks and non-bank lenders because we rely on it as a key source of funding.

Frank Ganis (Macquarie)

Competition is about right based on what we have experienced in other markets globally over the last five or six years. In my view the regulators engaged at the right time and implemented sensible policies in relation to protecting the market from running away and getting overheated.

I think more competition is required in the future as the market stabilises and expansion of funding opportunities grows. For example, development of potential funding for mortgages like in Canada, where the Mortgage Bonds are 'enhanced' by the government to support growth and funding, which may also help banks with regulation.

Where will new non-major competition come from?

James Hickey (Deloitte)

When we asked last year where most non-major competition would emerge from, the majority of respondents said large regional banks or new online lenders. This year, while online still remains a key competitive threat, the vote for regional lenders appears to have reduced and non-banks lenders have stepped up. Any views on this?

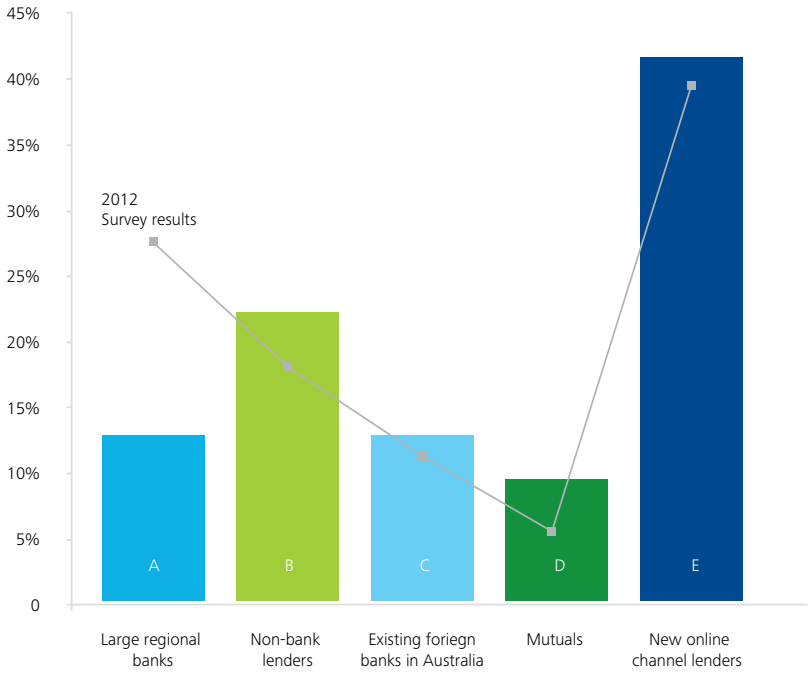


Figure 12: Source: Deloitte Actuaries & Consultants 2014

Clive Van Horen (CBA)

I suggest one of the reasons for the drop in competition from the large regional banks from last year's survey is that they are no longer 'new'. There are more large regional banks in the market, with the likes of Suncorp, BOQ, Macquarie etc. that are much stronger today than they were a year ago.

Steve Kane (NAB Broker)

New non-major competition will come from the new online channel lenders – but not merely online but the 'new' entrants such as the supermarkets coming into banking. That's where there's likely to be change.

Clive Van Horen (CBA)
As for the new online channels it is not an either/or, it is both. The future will be more about how digital will be integrated into everything else. You may know of the example in the US: Quicken Loans? Its legacy is as an accounting software company. Fifteen years ago it didn't do mortgages. Today it is the third largest mortgage writer in the US. Given our very healthy profit pool here in Australia, lenders like Quicken and organisations like Coles etc will have to be looking at our profit pool.

The future will be more about how digital will be integrated into everything else

Rob Plow (UBank)
I think the uptake will be consumer-driven. Currently there is only a certain segment of the market that is willing to completely self-serve and go through 100% of the fulfilment process online. When this expands there will definitely be an opportunity to be disruptive. However building the confidence of all consumers as to the benefits of self-service will be a challenge.

As for increasing competition, the focus of the conversation around this table so far has been about what actions the Government and the banks themselves will undertake. I think the consumer will also drive this competition, as access to information through digital becomes more and more widespread. This is especially true in Australia due to the comparatively high take up of mobile devices.

The interesting point will be how customers interact with mobile

When our customers get to the point that they are willing to spend every day on their mobiles, this confidence will then expand an expectation that they will be able to do more and more while they are mobile, and that will have a large impact on the market.

Brad Gravell (ANZ)
Google published an interesting statistic showing a direct correlation between online searches for home loans and a three month lag for system approvals. It suggested a much higher correlation than any other online 'research-to- purchase' activity which consumers are doing. The bottom line is that vast numbers of consumers are actually shopping for mortgages online. At the moment they are going offline to other channels to fulfil.

As soon as someone can make that next step and then the next step, and remain comfortable to stay in that online environment, given customers are starting there, that will be the 'tipping point'. It won't necessarily be end-to end, but there will be players in this space, both traditional and new, that are harnessing this consumer trend whether we like it or not.

Vibha Coburn (Citi)
It's like payments. Payments use to be sacrosanct solely to bank providers. Now we have Paypal and online retailers like Amazon that asks you to pay through your Amazon account although there is bank issued credit card at the end of it.

Matt Lawler (Yellow Brick Road)
That's why it's important. When we talk digital, it's an amorphous mass. You have to break it down. To me digital is in three parts:

1. **Customer acquisition:** to set yourself up with a website, to let people know what you do and invite them to come to you. This is capital light.

2. **Back end:** As Lisa mentioned digital is also more and more about what you do at the back end with data and the ability to present your data so that people and intermediaries etc. can see it and use it.

3. **Transactions:** The bit in the middle – how you transact and how you become a customer very quickly and very efficiently, that's the stuff that scares me if we are not addressing it.

We can do the front end ourselves. We don't need large capital projects to do that. There are people out there that will do it relatively cheaply. All banks do it and a lot of specialist organisations can do it for smaller businesses like us too.

But the bit in the middle – if you can nail getting the transaction done so that a consumer bypasses the intermediary, and then bypasses going to a branch – that is what will destroy the traditional business model in financial services.

Disintermediation has had a big impact on retailers like David Jones and Myer. It destroyed music retailers like Brash's and Sanity. As soon as you can do all you need to online and become a customer – without the need for an intermediary – then that scares me.

Even though I would always argue that face-to-face advice is the best advice you are going to get, I am not going to sit around and ignore this possibility.

Lisa Claes (ING Direct) Michael Russell (Mortgage Choice)

Michael Russell (Mortgage Choice)
The strong digital brands do concern me. Google, Yahoo, Coles, Woolworths and Apple are the ones that alarm me in terms of their capability to quickly morph into a financial services business.

Lisa Claes (ING Direct)
Those brands have reshaped customer expectations. Customers don't look at everyday consumables and financial services in compartments. Google, Apple and Amazon have completely reshaped what customers expect from any product or service provider. And they say: "Why can't my bank do this as well?" And the bank that does: that can deliver quickly, and offer access, transparency, and immediacy while providing financial services' well it will be the financial services institution that will win.

Matt Lawler (Yellow Brick Road)
There is, perhaps, an impediment with the current incumbents in that they have multiple channels. So if a major lender for example, which gets a big chunk of its business from the intermediary market, was to become hugely successful in their direct channel, at the expense of investing in and making it easier for the intermediaries to do business with them, then the intermediaries would vote with their feet. An incumbent, whether it is a major bank or otherwise, does and will have a lot of channel conflict and therefore difficulty getting their direct channel to dominate. But Lisa, I think you're right. If someone that doesn't have that channel conflict 'baggage' or that legacy, says: "I don't care," they will win.

Chris Wilson (Deloitte)
Quicken is really interesting because what it has done really well is to change its business model from the provision of accounting services to small businesses, to accessing the data resource of its amazing customer base.

Quicken quickly saw that it was having conversations with its customers about their finances. It knew where its customers' loans were. It was very easy for them; because it is not an easy thing to do, although it may be an easy thought process.

> The thing that is missing from this conversation is the difficulty of doing something like this

Chris Wilson (Deloitte)

It is useful to look at where the other organisations, with customer pull-through and customer loyalty, are at. Like mint.com which is a classic example, or wasabi.com. These are/were personal financial management websites in the US.

What I love about the Mint.com story is that they weren't a bank. They had no products. But they let you very quickly upload your data and get, on a single page, the 'best-of-breed' financial management available at the time. It wasn't just a pie graph. It was a really quite powerful description, backed up by crowd sourcing that also dealt with comparisons.

It was then very easy for someone to buy them and offer banking products to their millions of customers who were more loyal to them than their bank. Mint.com's loyalty was born out of the fact that it was not trying to sell a product, they were just 'trying to help me manage my business.' The Quicken story came from that same well. It therefore was not hard for them to jump onto the other side of the fence and say: 'If I had a deposit product, a home loan or a small business loan, would you buy it from me?' Small business people will most likely say: "Well you're the most logical person to do that with."

Katherine Milesi (Deloitte)
Extending that story on a personal level – I would love my bank to proactively sell me something in a personalised way. It's about using the data the bank has about their customers to identify those more likely to be interested in a particular product or offer – and then personalising the approach to the customer, not necessarily in a labour intensive, private banking way.

Lisa Claes (ING Direct)
That is the customer of today. And it has changed so rapidly. Five to ten years ago we would be horrified if any provider would have had the audacity to look at our data and say: "Oh Lisa we think you might need 'X'". We would have thought: 'How dare you!' But Facebook and social media have smashed those barriers.

We at ING Direct provide services globally and in some countries send texts and SMS messages to customers to say, 'Your balance is getting low on your transaction account, so be careful when you go shopping next.' They love it! 'Oh thank you,' is their response today.

Michael Russell (Mortgage Choice)
Can a strong non-banking digital brand expand into financial services? How far can a brand like Google and Apple, expand their propositions? They are the ones that we stay awake at night worrying about. I can understand Quicken expanding into financial services. But can a non-aligned brand stretch infinitely into financial services?

Matt Lawler (Yellow Brick Road)
In transactional interactions, yes, but that's why the migration to advice is important. Because it is not just a transaction, it's a more connected value add. But if you are just doing the transaction, and the internet comes along and replaces you, you have no one to blame but yourself.

Funding trends
Is the tide finally turning?

As Australian lenders adjust to lower levels of overall housing growth, funding availability and cost remains a key focus in order to manage margins and meet shareholder expectations. This continues to drive banks to optimise their funding mix and offers hope to non-bank lenders that they can reignite their funding models after years of financing challenges. Deloitte Banking Partner **Graham Mott** and Banking Director **Heather Baister** consider the recent trends and what the market can expect.

During 2013, and heading into 2014, global funding markets have further stabilised after the uncertain periods of 2011-2012. While the threat of market disruption by events such as the US fiscal cliff will remain front of mind for many institutions reliant on wholesale funding, generally Australia continues to experience a healthy funding environment,which is aiding all lenders and ultimately borrowers.

Cost of funding

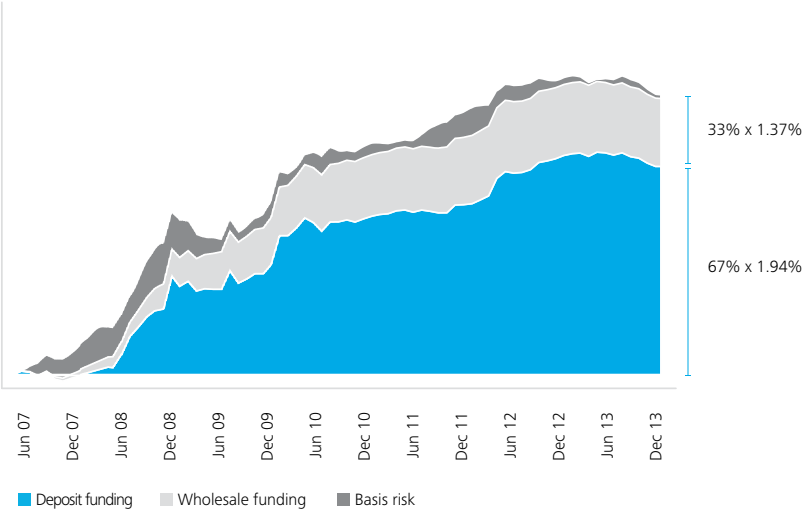
Deposits

Major and non-major banks have continued to grow their base of deposit funding, and this shows no signs of material easing in 2014. Competition for deposits remains strong, with Authorised Deposit-taking Institutions (ADIs) offering returns on at-call saving and term deposit accounts well in excess of the cash rate.

This spread over the cash rate for deposit funding can range from +0.7% for terms of 1 year to over 1.50% premium over cash terms of 3 years or more.
The banks are willing to pay this as they are preferring the stability of deposit funding as well as seeking to increase their overall weighting to deposits in anticipation of the revised Basel III rules which give preference to 'sticky money' (that is, funding which is more likely to be held on an ongoing basis), and which from 2015 will contribute to the liquidity coverage ratios that they are required to maintain.

The diagram below from the Commonwealth Bank of Australia shows this increase in the size and cost of deposit funding compared with other sources of funding. It shows that CBA are now raising 67% of their funding for mortgage lending from deposits, and their cost of deposits has increased by 1.94% since 2007 relative to the cash rate.

Increases in funding cost mix



	Jun 12	Dec 12	Jun 13	Dec 13
Increase in wholesale funding	1.65%	1.43%	1.37%	1.37%
Increase in deposit funding	1.86%	1.96%	2.01%	1.94%
Increase in weighted average cost	1.78%	1.77%	1.79%	1.75%

Figure 13: Source: Commonwealth Bank of Australia 2014

Average long-term wholesale funding cost

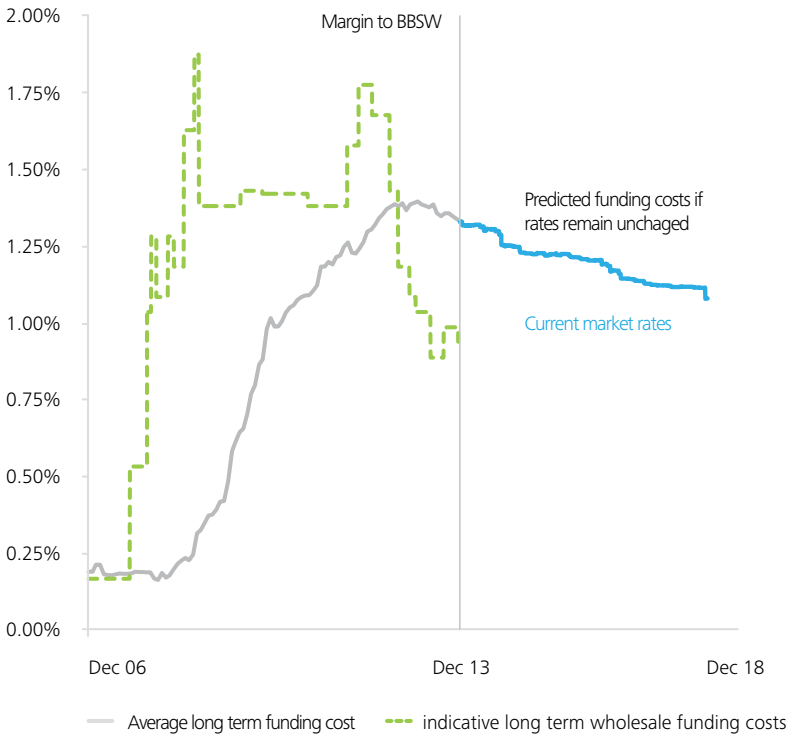


Figure 14: Source: Commonwealth Bank of Australia 2014

Deposit pricing is now having the most significant impact on ADI funding costs

This momentum towards deposits has been supported by demand meeting supply – bank demand for deposit funding has been met by consumer and business willingness to invest in deposits. That is, since the GFC, investors have actively sought to place their investments in deposits, favouring the security of the return.

This does beg the questions however: 'What would be the impact on deposits should an equity market rally occur? And what would this do to the already high costs of securing deposit funds?' Banks may have to increase deposit rates further in order to attract such 'sticky money', impacting their net interest margins.

Wholesale

While deposits have maintained their relatively high cost, the positive story as we enter 2014 is that wholesale funding costs for new issuances keep reducing compared to their height during the GFC.

Major banks in particular are hitting a period where their foreseeable average wholesale funding costs are likely to reduce. This is a function of the spreads on the expensive wholesale debt raised during 2008-09 being replaced at maturity by the current relatively lower cost of wholesale debt.

This is shown in figure 14 above. The high spreads on wholesale funding during 2008-09 of up to 200bps are now being replaced by current wholesale funding at less than 100bps, resulting in a reducing average cost of long term wholesale funding.

What does this mean for competition?

Return of the Non-Banks

One notable area of increase in market competition in 2013 was the non-major ADI market, where banks such as ING, Suncorp and Macquarie, which were once seen as emerging competition for the majors, are now considered more prominent players in the lending market.

As we stand at the start of 2014, the improving wholesale funding situation also allows non-banks to look forward to a re-emergence in the year ahead.

The situation for non-banks is that they are now able to achieve a sustainable level of profit margin. This is in contrast to prior years where the funding cost was still largely prohibitive. In our 2012 Deloitte Mortgage Report we estimated non-bank lenders to be able to achieve a NIM of less than 80bps.

We estimate that for non-banks, due to the improving cost of wholesale funding, this has now expanded to over 100bps, which results in a potential profit before tax of up to 40bps for such lenders.

Figure 15 shows our estimate of the margin on newly issued mortgages for a major bank compared to a non-bank.

While our estimates are that a healthy 200bps of NIM (for newly originated loans) is still being achieved by the major banks, this margin has reduced since 2012 as competition has led major banks to deepen their discounts to customers and increase their commissions to brokers in order to compete for new flows in the market.

> This increased opportunity for non-banks to more actively re-enter the market as we head into 2014 will be a positive for competition and borrowers

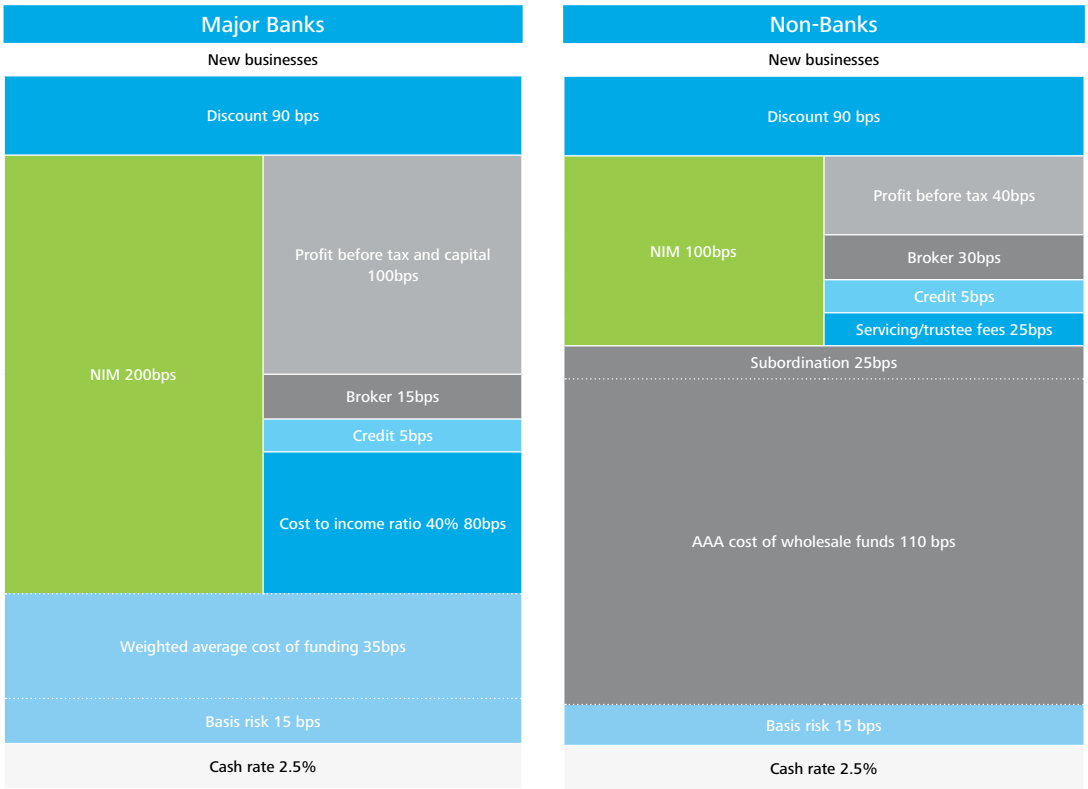


Figure 15: Source: Deloitte Actuaries & Consultants 2014

Specialised lending

While the main driver for credit growth in the residential mortgage market remains 'prime' mortgages, we believe there is opportunity for non-bank lenders to significantly reactivate the specialised lending market. This would be what was previously referred to as the 'near prime', 'lo doc' and 'non-conforming' markets. Typical borrowers for these products are often self-employed, small business owners and those that lie outside of typical lending criteria of the larger banks.

The major banks have been nervous of relaxing their credit standards which were tightened in the midst of the GFC. This has resulted in many 'near prime' borrowers only able to be serviced by the non-bank lenders. However, until recently, wholesale funding availability and cost made this a challenge for such non-bank lenders.

Given the improved wholesale funding situation, this now provides non-banks with a chance to be more competitive in not only the prime mortgage market but also the near prime market. This market allows such non-banks lenders to operate at a slight premium to the rates offered by the majors to prime borrowers, reflecting the higher risk profile and service provided.

In summary

With market expectations of interest rates remaining low for the near term, credit growth of the overall outstanding mortgage market will continue at the current modest levels. The requirement to maintain and nurture 'sticky deposits' while protecting mortgage market share will continue to be the focus for the major banks, and will be a balancing act between managing margins, pricing and operational efficiency to reduce costs.

This environment will provide opportunity for the wholesale funded non-bank lenders, who are increasing in confidence as finally they can achieve a level of NIM which will give them the opportunity for growth. Additionally, many of these non-bank lenders, particularly those with specialist lending products, will be able to tap a part of the market that has been underserviced for many years.

Those lenders that best harness the opportunities presented by the improving funding landscape will be best placed to access the growth opportunities in 2014

Technology and data

Digital continues to dominate planning with the industry determined to build better access and operational enablement for customers, facilitated through mobile. Once sufficient consumer comfort and transaction volumes are reached, along with 'simplified' solutions for cross channel integration, the competitive gates will open.

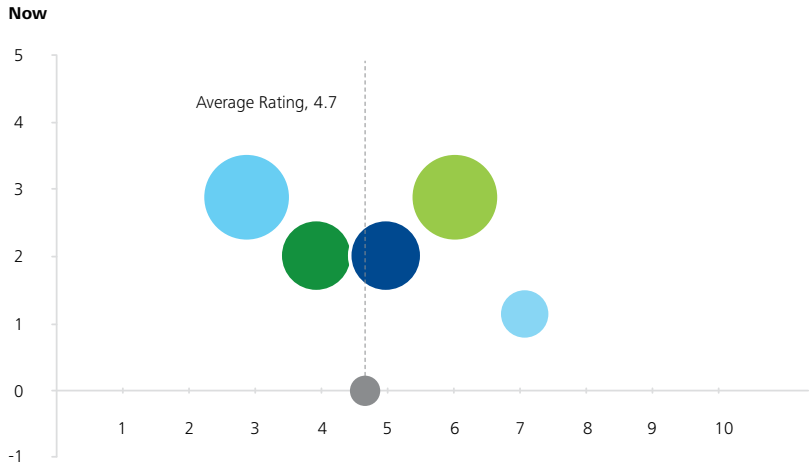


Figure 16: Source: Deloitte Actuaries & Consultants 2014

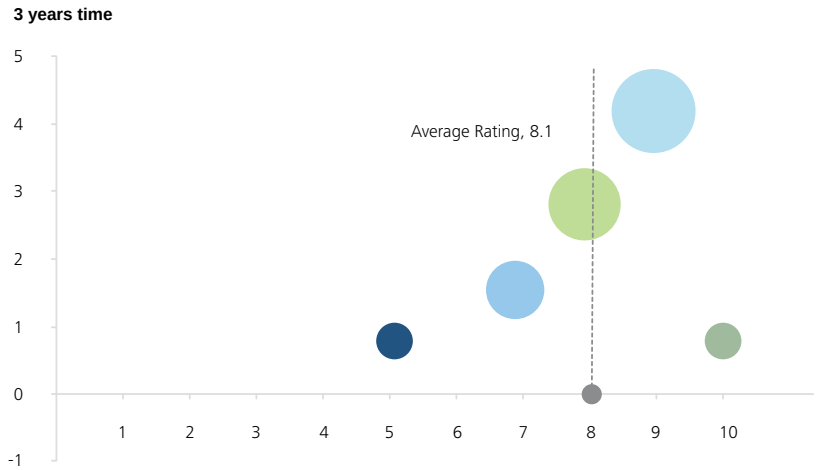


Figure 17: Source: Deloitte Actuaries & Consultants 2014

Where we are now and where do our digital skills need to be?

James Hickey (Deloitte)
Looking at the chart, you can see 'now' at the top, and 'in three years time' at the bottom. From left to right zero is effectively a digital dinosaur and 10 is absolutely evolving and leading the pack. So we seem to currently rate half way between the two at 4.7 and believe we need to be just north of 8 within three years (by 2017). What is fascinating is the quantum leap that you believe is required. Katherine given your experience across industries, is that a common gap? Or is this unique to banking?

Katherine Milesi (Deloitte)
I think a lot of companies would say we don't know what will happen in three years' time. Things are moving so rapidly that we aren't thinking only about digital tactics anymore. We are thinking about business models. 'Will our business be here in three years' time?'

Chris Wilson (Deloitte)
The other questions digital businesses are asking are: 'What are our digital skills?' and 'What are our consumers interacting with'? 'Is it web? Is it mobile?'

What we're seeing is that web and mobile will absolutely be there in the future, but we now need to include social and cloud and other things that will fundamentally change businesses. So the fact that, 'I've redesigned my website and it's fantastic and is across all platforms', and 'We've got mobile apps and they are excellent,' are almost table stakes. Everybody will be doing that. It has been happening for years.

Organisations that are embracing digital are having to fundamentally shift how they think, how they interact, and how they are engaging with customers, the data, and the social side of things. It's so broad. Also a lot of companies are getting the skills they think are needed today.

> But the skills needed in three years' time, like social business, are continually evolving

Graham Mott (Deloitte), Patrick Tuttle (Pepper Group)

Steve Kane (NAB Broker)
We can learn so much from our teenage children, their use of text and the way they use the internet to buy. They use the internet quite differently from the way our customers do. Home loan customers use it to get information on a mortgage and then go to a mortgage provider of some description. Digital natives on the other hand do their research at the shops, find the gear they want, then come home and find they can get it from the US for half the price. Their behaviours are not traditional. They're very savvy and maybe even naively trusting, online.

Graham Mott (Deloitte)
A challenge appears to be the difference in digital take up between the general Australian population and our corporates. I have a concern that there's a big dichotomy between where our consumers are at versus our corporates.

Michael Russell (Mortgage Choice)
This financial year I have signed off more than 50% of our marketing spend to digital. We are spending on YouTube pre-roles more than I could have ever comprehended three years ago. We certainly regard digital as our major customer acquisition channel.

James Hickey (Deloitte)
Clive, a brand like CBA can push digital, but can a digital brand pull banking customers?

Clive Van Horen (CBA)
It is an open question but I think it is a very strong possibility. Google as a brand is trusted more than many financial institutions' brands because, if you think about it, Google is more ubiquitous than a pen – people use it every day and, for many customers, more frequently than a pen. So it is in their lives daily, and it delivers a great experience. Obviously it is still a bit of a stretch to pull banking customers entirely away from their banks but given the way they invest in innovation they are a real competitive player especially in the payments arena.

Frank Ganis (Macquarie)
Your question really resonates around the word 'brand' and the trust and credibility it stands for. With trust and credibility, you capture the attention of your clients, the market and your staff, which places any individual and organisation in a position of influence and strength to offer their services and products. What consumers are looking for, especially after the displacement that has occurred over the last ten years, is trust, credibility and something that they are confident will be sustainable over a period of time. Public perception is probably that Google has met those expectations and has earned the right through trust and credibility, placing Google in a leading position.

Rob Plow (UBank)
To build on the trust discussion, financial services, and especially advisers, still struggle to be trusted by the majority of Australians. And this hasn't changed, as most customers don't see financial advice as one of their primary demands.

Rather than trying to grow by taking a customer from a competitor, the greater opportunity is how we build trust to get the 70% to 80% of people who don't engage, to engage. While this is normally positioned as a wealth optimisation service, the vast majority of customers just want to make sure that they are minimising making financial mistakes.

Frank Ganis (Macquarie), Katherine Milesi (Deloitte) and Clive Van Horen (CBA)

For the majority of customers there are five or six things they should look at and address in order to do this, including optimising their home loan, having an offset account, building up an investment portfolio, using compound interest, having adequate insurance etc.

If we aren't scared of opportunities to disrupt the industry, we should be. Someone like Google knows that a customer is looking for a new home loan much earlier in the process than the banks do.

The market opportunity here in Australia is to deliver products and services to customers that they don't even know they need or want, and to do so in such a way that they just use it

Rob Plow (UBank)

Chris Wilson (Deloitte)
As we talk to a lot of people in the industry, Google's name always comes up. And it's not because we think of them as a bank – it is because of the data they have.

I think that's where we will find Google is smart and may well stumble across something sooner than we would want them to

Their asset is my data. So when it comes to choosing a credit card I may well think that I'd be better off with Google because they know more about me and my broader lifestyle than just my financial services. Apple is also really, really interesting. Apple has access to potentially millions of credit cards, which are currently used to buy 99 cent apps and $1.99 music.

I don't want Apple to be like a bank, but given they have all this credit information, I may just be interested in an Apple credit card as it is easier. If you're an Apple, the business case stacks up because you've seen the transaction flows for your primary offering that you are going to get from this. So when we look for brands outside our industry it is because they have access to something else. To me it always comes back to data.

Mike Russell (Mortgage Choice)
Australians are still very conservative when it comes to disclosing their personal information. I am not so sure they would willingly provide this online to a brand that doesn't have a trusted history in financial services.

Lisa Claes (ING Direct)
In Spain we offer loans based on the credit card and transaction history. We make it very easy. We offer customers unsecured credit – without the need to ask them for any more information. We simply harness the information we already have.

Chris Wilson (Deloitte)
In the future who is to say that the data you need today, is the same data you will need in the future? You are right about the, 'I want you to give me data' issue, because we are still conservative.

However there are some very interesting companies springing up that are saying:

> I'm not going to ask you that question I used to ask you. I've seen enough from your utility bills and your social messaging. And so I have enough information to give you the loan. We don't need any more data

The interesting thing is they won't have to ask.

Matt Lawler (Yellow Brick Road)
It is an incumbent problem. As financial services we think because we have control of the data, we have control of the customer. Unfortunately the data is going everywhere and there's plenty of opportunity to assess the creditworthiness of an applicant without putting them through the 'wringer' to get more data – data that may already be available elsewhere.

We are all involved in banking and it seems that we are trying to make it as difficult as we can to get a loan! We've created a model that is very, very regulated. All they really need is for someone to ask the question and offer the product based on what they already know about the customer.

The path to omni-channel growth

The rapid rate of change in digital technology is challenging even the most innovative and agile of financial institutions. Just as the financial services community is coming to grips with the power of mobile, along comes wearable technology, contextual computing and more, offering a whole new set of possibilities. Deloitte Digital Partner **Katherine Milesi** discusses an approach that navigates the challenges.

One of the greatest challenges of the times is not about the technology itself, it's about how it is stitched together, that is, how we bring the technology pieces of the puzzle together in a way that makes customers feel like they're interacting with the same brand, and getting contextual help and support, across all touch points and through all channels.

Enabling the customer

As technology and devices proliferate, so does the complexity of serving customers. Many customers today get a siloed channel experience. They may be able to achieve what they want in one channel, for example online banking, but this doesn't carry across to the branch or call centre. Customers want to be able to start, execute and complete a transaction through different channels as well as have personalised offerings delivered through their channels of choice, be they mobile, social media, web, phone and face-to-face.

Furthermore, customers want their banks to make life easier for them by using the unique data they have, to help them better manage their money. A simple example (that many banks still struggle to deliver) is the ability to save an incomplete online application form and then call a sales assistant who can expedite completion. Being able to switch from one channel to another, without losing data or context, is what has become commonly known as omni-channel banking.

A pure omni-channel banking experience would require the following types of capabilities:

- All products, prices and promotions are visible and available across all channels
- The details of the customer's relationship with the bank is known in all channels
- Any transaction can be performed in any channel
- Personalised offers and communication are delivered in the customer's preferred channel
- Customers get help when they need it, and even when they don't expect it (using predictive analytics)

Most banks have, understandably, followed a similar digital evolutionary pattern and concentrated their innovation in siloed channels, paying little attention to the cross channel customer journeys.

For large banks, the path to omni-channel is a daunting and perplexing endeavour. One of the challenges is that most of the decisions that shape the customer experience are made deep within the organisation, at a level and speed not visible to the Executive Team. These decisions are at the discretion of product, digital, marketing and IT teams who are racing against time, with limited budgets, to deliver.

What the Executive needs to do

There are critical actions an Executive team must take to build and mature an omni-channel organisation. These include:

- Business strategy and executive commitment– building an omni-channel infrastructure will challenge every fibre of the organisation as initiatives cross hierarchies and departments, and existing processes and structures are tested. A clear customer vision and mandate must be established, agreed and communicated, accompanied by a compelling business case. Cross functional co-operation, at the highest level, is essential
- Pervasive customer centred philosophy – organisations often look at their customers from the inside-out. This can be a good proxy at times, but is never a substitute for walking in the shoes of the customer. A systematic approach to customer research will pay high dividends in the form of retention, revenue uplift through cross sell, cost reduction through self-service and enhanced reputation. The customer philosophy must pervade the culture of the bank, requiring a concerted change management effort

- Operating model – in terms of structure, banks are typically organised along product, channel, service and functional lines. The question then is 'who owns the customer experience?'. The fact is, everyone contributes to it but ownership is often lost in the matrix. Some banks have resorted to employing Heads of Customer Experience to sit across all customer experience shaping activities, but oftentimes their lack of real power means their role is more about the creation of standards, templates and style guides

  – An organisational structure based around customer segments is not necessarily the answer either as channels transcend segments

  – A deeper solution is instilling a customer centred design philosophy where all teams are empowered to challenge the status quo and weave the right kind of customer research and interventions into the design and delivery of products and channels. Contemporary approaches including Design Thinking and Agile are excellent ways of bringing teams together to focus on the customer

As many of our global retailers have found, building an omni-channel business is several orders of magnitude more difficult than delivering a good customer experience in a single channel. As customers become ever more dependent on technology to run their lives, the benefits are immense

Katherine Milesi, Deloitte

- Data strategy – data is the key enabler of the personalised, cross-channel customer journeys of a customer centric organisation. At an individual level, a single view of customer is the pre-requisite for effective cross selling; at an aggregate level combining the bank's own data with external data sets, including census, household, social and web, can produce granular segments that when targeted with the appropriate message, have conversion rates demonstrably higher than traditional campaigns. Start small, test and learn, prove the value and then embark on the inevitable long term journey to customer insight driven analytics and actions.

The path to omni channel growth

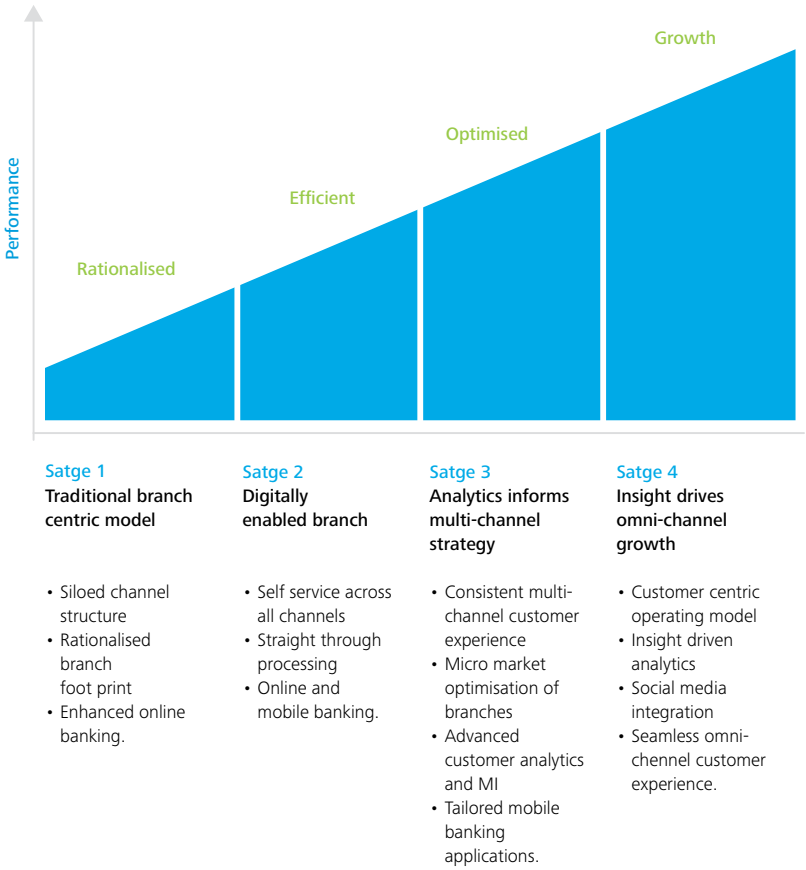


Figure 18: Source: Deloitte Digital 2014

Structural improvements

The financial services industry needs to find ways to converge banking, wealth, insurance, and superannuation to better deliver on customers' needs for simplicity of function and service. The offerings discussed included aggregated accounts that anticipate and respond to changing needs and life cycle stages.

Where should the Financial Systems Inquiry place most importance in relation to mortgages?

James Hickey (Deloitte)
Certainly a key talking point of 2014 and beyond will be the Financial Systems Inquiry. It seems from the collective response to this question that while all aspects will be important to cover, a particular opportunity exists to integrate superannuation with mortgage lending.

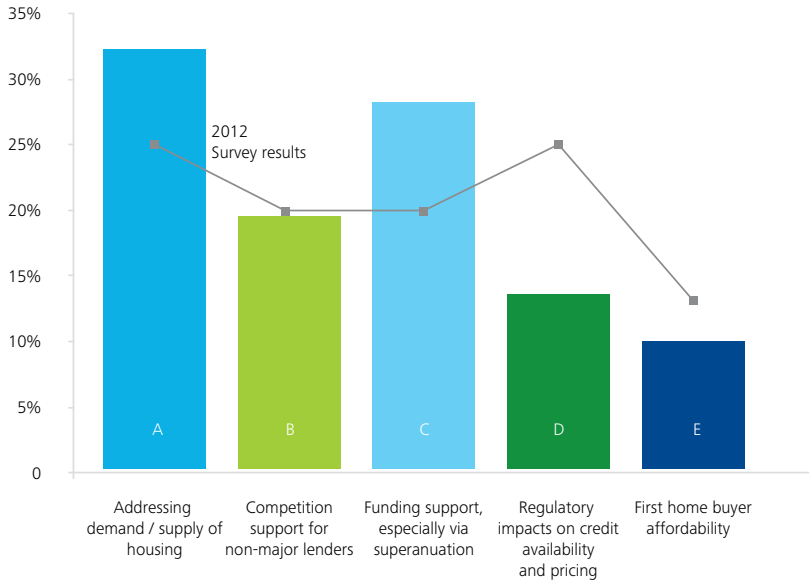


Figure 19: Source: Deloitte Actuaries & Consultants 2014

Clive Van Horen (CBA)
There is no doubt that funding and the interaction between banks and super is going to be a big theme in this Inquiry. The questions, according to the term references, are about the future, the next 15 years, and the shifting pools of where the cash is and how that is going to feed back into the economy to support income and growth, lending and credit lines.

The link between super's pools of cash, and bank balance sheet's pools of cash, is critical

Patrick Tuttle (Pepper)
I think that allocating superannuation money to fixed income as an asset class, and away from the dominance of equities, will be a good thing. Currently the investment portfolios of Australian superannuation funds are heavily skewed to Australian equities due to the attractiveness of our dividend imputation system. But if there were a broader investment allocation to fixed income product, that would help my earlier point of supporting a more vibrant securitisation market. It would create a larger pool of domestic fixed income investors, which in turn would mean that domestic RMBS issuers are not forced to go offshore as often as is currently the case.

Quite frankly, the Australian market can't absorb the non-bank and bank securitisation paper that is issued annually in this market. This is because the domestic investor base is not large enough.

James Hickey (Deloitte)
Given the commentary in the media about both the pace of Basel III reforms and the regulatory relativity between major banks and non-majors, is it surprising for the group that it appears regulatory impacts were rated as less important this year than last year?

Brad Gravell (ANZ)
My view is that regulation will be an ongoing challenge. Importantly, it also relates to the ultimate price customers pay for different products & services. The more costs potentially that additional regulation creates for the incumbents in the industry, ultimately that will manifest itself somewhere downstream.

How will regulation ultimately help First Home Buyer affordability for example? How the regulators are thinking about the industry and its goals, and how they are all interacting with each other, is a key issue.

I am quite interested in First Home Buyers. I think about some of the topics that come up in the press about tax deductibility for First Home Buyers for their home loan repayments as in other markets, for example. The Inquiry needs to explore affordability in ways that aren't necessarily about tax payer funded grants, but about how to buy your first home possibly through super and how can that can be supported, perhaps through negative gearing.

How can superannuation be best integrated with mortgages?

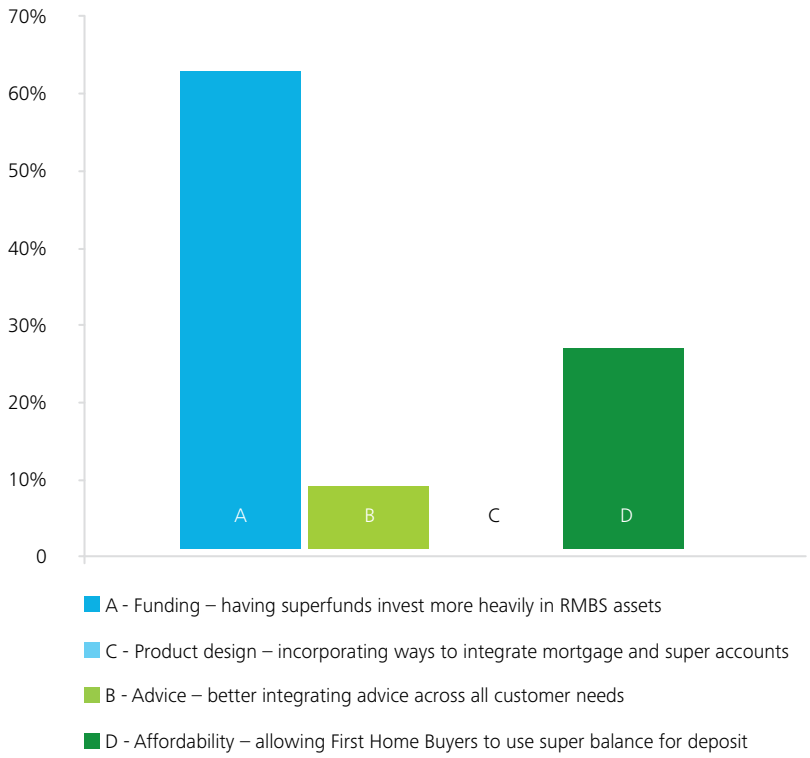


Figure 20: Source: Deloitte Actuaries & Consultants 2014

Matt Lawler (Yellow Brick Road)
The chance for this Financial Systems Inquiry for financial services to be far more integrated is exciting.

The Campbell and Wallis Reports were very much banking centric. I think the opportunity for this Inquiry is to recognise the intersection of superannuation and property.

> There no longer is one great Australian dream. There are two dreams running in parallel. One is to own your own home and the second is to retire comfortably

These are the two things people aspire for in a financial services sense. With an aging population we are putting real pressure on the social security system.

That the social security system will still be around when the next few generations retire may be just a pipe dream.

As we prioritise the future of government spending with education, health and looking after the disabled and less fortunate, becoming more prominent, we have a big funding problem to enable the average Australia to retire comfortably.

So I think affordability of housing for younger Australians, and the potential superannuation funding shortfall for future generations of retiring Australians, need to be the two key focus areas of the Inquiry.

Lisa Claes (ING Direct)
Super, even at 12%, is still dreadfully underfunded. Super and home ownership are the bar bells in the financial services industry. The two can't work together unless you get brutally realistic about how much we should be contributing.

We need to fulfil Keating's original architecture, which was to mandate super contributions at 15%.

> *Super and home ownership are the bar bells of the financial services industry. Ideally we need to be brutally realistic about how much we should contribute*
>
> *Lisa Claes ING Direct*

What is the biggest concern in the mortgage market?

Graham Mott (Deloitte)
We've discussed where you are seeing growth, opportunity and optimism. I wanted to ask more about the threats you see over the horizon.

The race for market share is increasing and APRA is obviously concerned about any credit risk implications of this. However the interest rate environment must be very encouraging and assisting leverage in a major way?

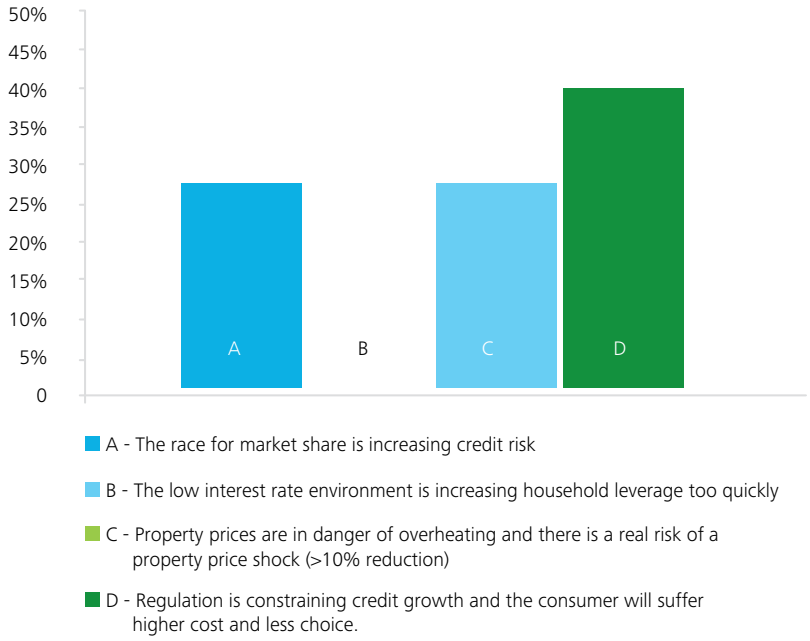


Figure 21: Source: Deloitte Actuaries & Consultants 2014

Brad Gravell (ANZ)
Banks do have to worry about this issue. Customers have generally adopted an accelerated amortisation pattern and our books aren't growing in the same way as they used to. So while we look for ways to continue to grow, we need to be very mindful of the potential risks in this type of environment.

Clive Van Horen (CBA)
I chose the property prices option even though I don't believe there is a bubble today, contrary to the media speculation. I don't think the data or facts support a bubble. But I do think that if prices carry on like they are, there really is a significant risk of a correction. Particularly if we have another year like we've just had. That is, if prices go up 20+% in two years, it won't take a lot to have a bit of a correction and a correction will be quite painful.

Graham Mott (Deloitte)
Clearly you all still clearly concerned about regulation constraining credit growth and ultimately penalising the consumer with higher prices and less choice.

Lisa Claes (ING Direct)
The words highlighted in 'D' are 'higher costs'. The larger players have the scale to absorb the costs; the smaller players less so. As a general comment, I am proud of the fact that we've survived the GFC with the most resilience in the world. But I am not proud of the fact that we are probably the most over-regulated environment in the world. Because it just translates into cost for the customer.

There is just this build-up of regulatory plaque. We don't ever seem to pause to pick axe it off.

We just add on and I am not quite sure that the regulation is 'fit for purpose'. I look at our numbers in the front office and in the back office, compared to the growth in our risk and legal departments, and it's at the cost of the revenue generators. If that's happening in a smaller bank, I would hate to think what is happening in a larger organisation.

Clive Van Horen (CBA)
I absolutely agree. Although most regulation is ultimately about protecting customers, they also eventually bear much of the cost of regulation.

I guess my answer to the question was relative to other industries, like the financial advice industry, which counts the costs of regulation in the hundreds of millions, or billions of dollars, not tens of millions. So I think the prospect of the lending industry facing a similar level of regulation as under FOFA, would seriously constrain credit growth.

Lisa Claes (ING Direct)

Matt Lawler (Yellow Brick Road)
There is a really important point earlier where Frank talked about the consumer. We don't want to attract more regulation there is no doubt about that. I think if you speak to those in the financial planning industry under FOFA, if they had their time over again they would probably have made decisions earlier so they would not have got the over regulation that they did.

My concern, in this race for market share, is that there are a two trends occurring that I see that are heading us towards a "FOFA" moment. The way we advertise mortgage rates is getting out of control.

Mortgage promoters are just advertising the discount and not actually talking about the underlying mortgage rate. In ads on TV, a number of promoters are headlining discounts of 1%-1.1% and not mentioning the underlying rate after the discount.

Don't worry we had this moment ourselves at Yellow Brick Road where we looked at it last April and said what are we doing?

Why are we advertising the discount, when the rate, the bottom line rate, is what's really important? We have changed our approach here and we believe it is important the industry does too. Truth in advertising builds trust with the consumer.

The other area that needs to change is in the intermediary market – incentivising brokers. It only takes one or two banks to create a trend and then everyone starts to do it.

What I am referring to here is short term incentives to Mortgage Brokers to write volumes with a specific lender. That is saying to a broker, 'That if you do so many loans in the next three months we'll give you an extra $10k or $20k, or we'll give you an extra 20 basis points'.

That, from a consumer's point of view, is their worst nightmare. When a consumer walks into a brokers' office thinking they are getting independent advice, they are not aware that this broker is motivated by the fact that the next loan that they put with X bank is going to tip them into bonus territory.

So regardless of the clients' situation, the broker already knew their answer.

Mike Russell (Mortgage Choice)
I think it's hard to argue that regulation has stifled credit growth, when this financial year we are up 17-18% year on year with new home loan flows. From a consumer point of view they have been rewarded with historically the best mortgage rates we have ever had in this country. So you wouldn't want to mount any sort of argument that regulation hasn't been a positive thing for our industry.

With respect to a "FOFA moment", I think NCCP has done a wonderful job elevating the professionalism of our entire industry. We are all much more conscious of our 'best interests' and 'client first' responsibilities. That said, the conflicted remuneration issue is still a concern within the mortgage broking industry. The fact that brokers, in the main, are remunerated differently per lender and product must one day be addressed.

Broker channel

The challenges ahead include responding to an increasing demand from consumers for financial advice, simplicity, and cross-channel integration to make it easier for customers to navigate asset classes. Advice is key and successful broker groups will be those that diversify their businesses to take full advantage of providing advice.

What will the main developments in the mortgage broker channel be?

James Hickey (Deloitte)
We asked where the broker market needs to evolve to over the next 3-5 years. Two key themes emerged – holistic advice and remuneration models.

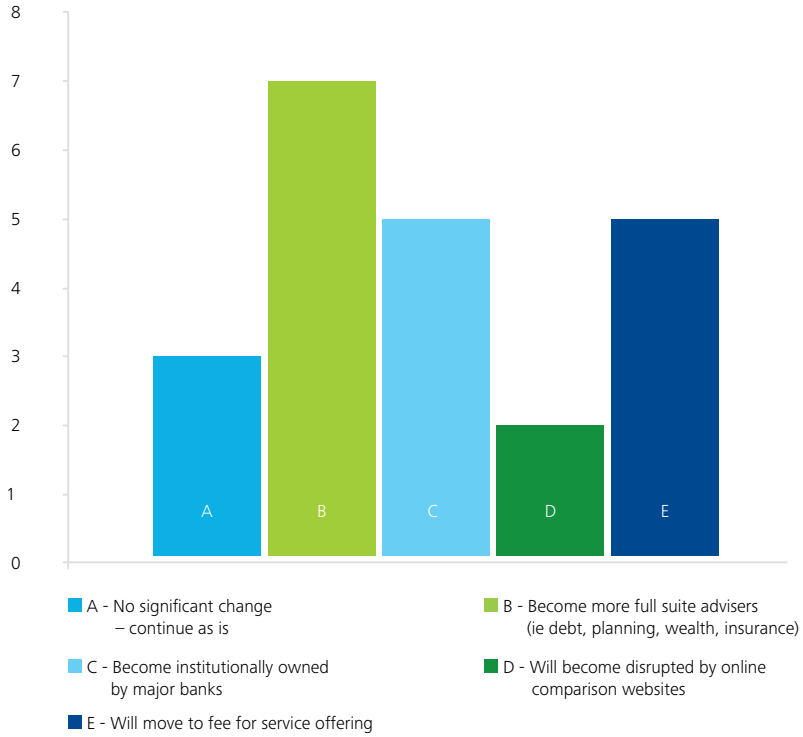


Figure 22: Source: Deloitte Actuaries & Consultants 2014

Steve Kane (NAB Broker)
I think the main developments in the mortgage broker channel will be around advice and will revolve around the customer. So becoming full-suite advisers around debt, planning, wealth and insurance will be important. The convergence I spoke of earlier revolves around the customer, who is looking for more from their financial institution and their broker.

Brokers have the capability to offer advice across a range of areas. That's where the focus for the broker arm will be.

We've moved enormously with NCCP over the last little while as Michael has said. We have moved away from the order takers in the market that simply filled in an application, and sent it to the bank that they thought would give them the highest commission, or the easiest approval.

Now brokers are conducting proper investigations with the customer. Identifying their needs and it should naturally follow that they will seek to meet all those needs.

Lisa Claes (ING Direct)
Brokers have a primacy in serving customer needs. They have an enormous chronological advantage that I don't think they have yet fully leveraged. Brokers are there the first time a customer seriously starts thinking about finances, when they buy a home, which usually happens before they insure, invest or retire. It's a great opportunity to put in the groundwork for further and fuller financial advice throughout the customer's entire financial life cycle.

Patrick Tuttle (Pepper)
I voted B for brokers becoming full suite advisers around debt, planning, wealth and insurance and then C – brokers becoming institutionally owned by banks – because banks will want to control the full suite advisory option. So, smart brokers will leverage their relationships. And as banks look to grow their market share, constrained as they are by record-low credit growth, they might want to consolidate by buying those distribution sources.

Brad Gravell (ANZ)
I think that the industry is at a level of equilibrium at the moment. Point B is really interesting to think about, as the current economics of the banks and the broker industry is that banks will pay a commission for the mortgage but they are interested in making sure they are getting more value out of the customer relationship through cross sell.

I have conversations with brokers regularly where our outbound call centre will call the mortgage customer about wealth products, for example, and the broker will be on the line saying, "Please don't contact my customer about other products". We are on the other end of the line saying, "Well that's also my customer."

It's an interesting one and I think Steve's right. That is where the industry is going. But it will have a very interesting impact on the dynamics of the industry. Who owns the customer relationship? It doesn't mean that we will end up in a bad place.

But it could really force a transformational change around the relationship between a lender and a broker, if a lender, for example, can't assume the right to have a deeper cross sell conversation with the customer once they've been introduced.

Steve Kane (NAB Broker)
No one owns the customer. It's not a mutually exclusive operation. The customer needs to access all the financial services that can be provided. How they access those might be digital, it might be face-to-face through a store, it could be via a broker or third party introduction.

It is managing that as one relationship with the customer.

Whoever gets it right first time will be ahead of the game

Brad Gravell (ANZ)

Brad Gravell (ANZ)
I agree with that. I actually believe option B is a very realistic future. It will force quite a transformation about how we all do it together.

Matt Lawler (Yellow Brick Road)
I think from a customer's point of view, it is what Rob said. 'Are they looking for a mortgage? Are they looking to buy some insurance?' In many ways what they want is to get financially organised.

When customers come with a mortgage they often don't know that they need insurance. But when someone suggests it to them or advises them on it and gives them good reasons that they should do it. They say, 'Yeah you're right, I have never thought about that.' Or 'I've been meaning to do it but never got around to it. Yes let's put it in place.'

So I think that the broader interaction with customers is really important. But we've got to remember that our customers don't wake up in the morning to buy products like insurance. If someone actually packages that for them, then we're on track. Getting financially organised is an iterative process as we know.

Moving from consolidation to fragmentation

I am interested that people are saying that the intermediated businesses will end up being owned by the major banks. I guess people will say that because it's our natural reflex, given what's happened in the wealth management industry, but I am of the strong view that these things go in waves. I have seen these cycles before. I believe we are moving out of the consolidation period and into the fragmentation period.

I am already starting to see some of the banks who have moved their management teams and their management style into wealth management companies, saying to intermediaries that we own you and we are going to tell you what to do. That really grates on that culture.

I think you will start to see them fragment. I know from experience that at the end of a cycle of consolidation, cheques have been paid to get some financial planners to move from one organisation to another. It happened in the 1990s at the end of the life insurance era and it's happening now. To me this is the trigger for us to see that fragmentation wave start to commence.

Lisa Claes (ING Direct)
I totally agree; although I say so for slightly different reasons. Consolidation was driven by regulation. Consolidation was not a customer-led epoch. Now the balance of power has shifted. It is very much in the customer's hands in this phase. It may end or maybe never end. I believe the preference for independence plays to the fragmentation model. I am not saying that vertical integration is dead or wrong but you need to be very careful in the way it is executed it if you want it to be sustainable.

I think today's more informed customer is increasingly going to be more sceptical when they go into a distributor, as to the drivers behind the promotion of a particular product or service.

Rob Plow (UBank)
I don't want to upset Michael or Steve, but is there a consensus that we are going to require brokers in the future? One of the key reasons brokers exist is because our industry makes it hard and confusing for customers. Therefore, they need someone to help them through the process. Brokers currently do that on our behalf as intermediaries. However by simplifying the process, and the demand from customers for greater transparency from the industry to build trust, this need will be reduced.

Steve Kane (NAB Broker)
I think what we do is devalue the customer relationship by assuming that the customer would come to us regardless of the service provided. And we also lose their trust. What brokers do is replace that with face-to-face and 'I'll look after you, and I'll do what's in your best interest.'

James Hickey (Deloitte)
I remember last year we spoke about fee for service and the year before that. The view then was that commissions would remain. But charging a fee for service raises the game for brokers and many of the successful ones already embrace it. Do you think this is a clear path the broker industry needs to follow?

Matt Lawler (Yellow Brick Road)
I am not convinced about that. I think it will go in waves. It was a real necessity to do that in superannuation, because it was legislated by the Government to grow. There were things that got out of control there particularly with conflicted remuneration. Insurance will be the next debate.

I think mortgages will be a debate after that. That's why I say as long as we neutralise the impact of commissions; as long as they are all roughly the same across lenders and you haven't got these schemes where promoters are paying incentives for volume over a very short amount of time, then we won't get into the issues we've had in other industries. I only say that so we have some common sense there, and there is no manipulation of the system.

Matt Lawler (Yellow Brick Road)

All competition should be around the features, benefits and the price for the customer. We should neutralise the commission piece and I think Mike's model does that really well

Deloitte thanks all the roundtable participants for sharing their views on the mortgage landscape so openly and look forward to following how their views and predictions around 2014 and beyond develop.

Contacts

Rick Porter
Leader
Financial Services Australia
Tel : +61 3 9671 7922
rickporter@deloitte.com.au

Graham Mott
Financial Services Partner
Audit & Assurance Banking Practice
Tel : +61 2 9322 7970
gmott@deloitte.com.au

Chris Wilson
Financial Services Partner
Growth & Strategy
Tel : +61 3 9671 7411
chrwilson@deloitte.com.au

Arturo Mauleon
Financial Services Partner
Consulting
Tel : +61 0409 707 750
amauleon@deloitte.com.au

Louise Denver
Director
Corporate Affairs/Communication
Financial Services
Tel : +61 0414 889 857
ldenver@deloitte.com.au

James Hickey
Financial Services Partner
Actuaries & Consultants
Tel : +61 2 9322 5009
jahickey@deloitte.com.au

Ian Harper
Partner
Deloitte Access Economics
Tel : +61 3 9671 7536
iaharper@deloitte.com.au

Katherine Milesi
Partner
Deloitte Digital
Tel : +61 2 9322 7030
kmilesi@deloitte.com.au

Heather Baister
Director
Audit & Assurance Banking Practice
Tel : +61 2 9322 5911
hebaister@deloitte.com.au

Deloitte Sydney
255 George Street
Sydney, New South Wales
Australia

Tel: +61 2 9322 7000
Fax: +61 2 9322 7001

Deloitte Melbourne
550 Bourke Street
Melbourne, Victoria
Australia

Tel: +61 9671 7000
Fax: +61 3 9671 7001

fsimarketing@deloitte.com.au
www.deloitte.com.au

MCBD_HYD_02/14_01567