THE BOOM - BUST ALERT
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"There is always a bull market raging somewhere on this planet" - *Byron King*

Low-Doc Lenders Beware!

by Joe Average,
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"A growing body of case law says it's the lenders who should look out when low-doc loans go wrong".
Tina Perinotto, 20 December 2006,
Australian Financial Review.

Court Ruling Alarms Low-Doc Lenders.

A recent ruling by an Australian court has sent shockwaves through the ranks of providers of low-doc and no-doc loans to sub-prime borrowers.

The court ruled in the "Khoshaba versus Perpetual Trustees Case" that the agent who wrote the loan had acted illegally because he had failed to establish that the borrower in fact had the capacity to repay the loan and would not default.

Tina Perinotto goes on to say ***"The ruling affecting the Resimac mortgage fund – one of Australia's biggest, with shareholders including Westpac Banking Corp and Macquarie Bank*** **– has sounded an alarm about the booming category of so-called low-doc and no-doc loans."**

In a precedent-setting decision the presiding judge ruled that the loan to Khoshaba be revoked and that Resimac not be allowed to foreclose on the family home in order to recover its money.

The factors that influenced the judge to arrive at this verdict were:

1. The loan application erroneously stated that the borrower had an annual income of $43,000 when in fact he was a pensioner. Mr. Khoshaba denied having made this statement of income.
2. The borrower, who's English was limited, said he hadn't fully read or understood the loan document.
3. The purpose of the loan had not been filled in on the application form. The borrower actually used the $120,000 to invest in a pyramid scheme that went into liquidation.
4. The broker had not acted ethically or responsibly in carrying out his duties to both the borrower and the lender, but **had relied solely on the security offered by the family home.**

In another case, a court ruled a loan to the No Fuss Finance Company was illegal because the borrower was unaware that the lawyer chosen to draw up the documents had been appointed by and was working for the lender. The company was subsequently deregistered.

Yet another lender had a loan overturned because they had not bothered to check that the borrower had a past history of falling behind on repayments on a previous home loan and intended to use the new loan to refinance said home loan. Rather, the borrower falsely claimed it was for business purposes.

Jon Denovan, a prominent Consumer Credit lawyer, has warned his banking and finance clients that **"there've been six cases that I think are important…. In all cases the money should never have been lent to the people because blind Freddy should have known it… the judge is saying that you can't just shut your eyes and act recklessly."**

Consumer credit lawyers now warn that the Khoshaba case is ***"just the tip of the iceberg",*** and that ***"buyer beware"*** has now been replaced with ***"seller beware."***

The Mortgage Industry Association of Australia was quick to warn its members that the courts are clearly putting the onus on lenders to act responsibly by establishing that the borrowers do in fact have the capacity to repay the loan, and to be aware of the risk of fraudulent loan applications.

With interest rates rising, and property values softening or falling in many parts of the world, lenders are becoming increasingly worried and watchful about arrears in loan books and the threat of a rising level of foreclosures.

It will be interesting to see if the legal issues raised in the Australian courts will translate to other parts of the globe that have also been engulfed by the recent credit and real estate booms should these show signs of deflating.

A New Niche Market…the Illiterate Poor.

The massive First World credit expansion and lending binge of recent years (ignited by Fed-induced historically low interest rates) now finds many borrowers up to their eyeballs in debt and tapped out. The added enticement of easy money through sub-prime loans and negative-amortization loans flushed out borrowers who would not have qualified in the past. If lenders are to maintain or keep building their loan portfolios they need to find ways of writing new business.

Consequently, lenders are feverishly looking for prospects in new pastures and new innovative ways of enticing more consumers to keep on borrowing.

Citigroup, the largest financial group in the world and always at the forefront of shrewd money practices, has **discovered a new demographic and a new niche market…India's illiterate poor.**

Joe Leahy writes from Mumbai, India (The Australian 4th December 2006):

"Citigroup's thumbs-up for Indian slum dwellers.
Citigroup is rolling out a network of biometric cash machines aimed at illiterate Indian slum dwellers…(which) ***will recognise account holders thumb prints, eliminating the need for a personal identification number, and will have colour-coded screen instructions and voice overs to help guide them through transactions."***

The first two machines have been installed, one in a slum area close to Mumbai's financial centre. It is hoped that some of the 700 million low-income Indians (out of a population of over 1 billion) who don't have bank accounts at present will be encouraged to establish a relationship with the bank rather than keeping their meagre savings under their beds. Citigroup also plans to ***"target the poor in big emerging market countries such as Brazil and Indonesia."***

Schemes are even being developed to bring banking services to illiterate farmers in remote areas via biometric cards and portable devices in an effort to circumvent the lack of electricity in these regions.

It appears that some of the world's most sophisticated financial institutions see an opportunity where they can tap a new market while at the same time claiming they will help the underprivileged, illiterate poor in these developing countries by giving them an opportunity to improve their lot in life… and that this will be done by **teaching them how to go into debt before teaching them how to read or write.**

How noble.

All the best, Joe.
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