Aussie

MORTGAGE BROKING
HOME LOANS
CREDIT CARDS
HOME INSURANCE

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Mr John Hawkins
The Secretary
Senate Economics References Committee
PO Box 6100
Parliament House
CANBERRA ACT 2600

BY EMAIL TO economics.sen@aph.gov.au

Dear Mr Hawkins

Inquiry into Bank Funding Guarantees

Thank you for inviting Aussie to make a submission on the Bank Funding Guarantees.

Executive Summary

- To reinvigorate competition between the banks and non-banks, strategies such as increased funding by the Australian Office of Financial Management (AOFM), the purchase of Residential Mortgage-Backed Securities (RMBS) assets in the secondary market and adoption of a securitisation guarantee model should be considered.

- The introduction of wholesale funding guarantees in the banking sector provides substantial advantage over those who do not have access to it. While the adverse impact is presumably unintended, it is significant and should not be ignored.

- The removal of the guarantee for bank wholesale funding should be a priority to allow efficient markets to operate. This should be done on a measured basis, in coordination with the removal of similar schemes by other sovereign jurisdictions, so as to avoid unintended capital flows between jurisdictions from arbitrage or simple risk return investors.

- In counterpart to the dismantling of the guarantee for bank wholesale funding, consideration should also be given to the removal of the guarantee for large bank deposits once the appropriate point has been reached where markets have stabilised and confidence is restored, in order to promote the efficient allocation of funds within the Australian economy. This would need to be done in a well forecast, understood and gradual manner.

Our Submission

The global financial crisis (GFC) has effectively eliminated securitisation as a funding mechanism and has concentrated home lending to the four major banks. This unparalleled shift in market share towards the major banks has the potential consequence of reducing the Reserve Bank's ability to affect monetary policy outcomes when the independent actions of the major banks do not align with the policy outcomes.

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Aussie's own experience as a broker reinforces the concentration of home lending where over 80% of new business volumes are currently going to the major banks.

Whilst the introduction of the bank deposit and wholesale funding guarantees were appropriate responses to the dislocation of the capital markets brought about by the GFC, continuation of the guarantee creates a significant bias in favour of deposits with and lending by banks and other ADIs. The differential in fees charged to ADIs to access the wholesale funding scheme further promotes an uncompetitive and less efficient market, and ultimately reduces diversification and increases financial market concentration risk. Despite this fee differential, the ADIs are still able to benefit from cheaper funding accessed through the wholesale funding guarantee until such time when the price of rated securities converge with guaranteed securities.

We accept that any withdrawal of the wholesale bank funding guarantee must be carefully handled and be coordinated with the withdrawal of similar schemes by other sovereign jurisdictions, so as not to create distortions in flow of funds, however it is appropriate that alternate strategies are put in place to help re-start the non-bank and second tier ADI market to ensure greater competition and choice for consumers.

As has been well publicised, the assistance provided by the AOFM has allowed some lending activity and in that regard is very welcome. However, that assistance falls well short of what is required to reinvigorate non-bank mortgage lending due to the comparative margins available to investors purchasing more seasoned RMBS on the secondary market.

A detailed discussion of the various economic models is outside the scope of this Inquiry. Suffice to say that we support the submissions put forward by some commentators for either significantly increased or amended AOFM funding mandates or the adoption of a securitisation guarantee model (eg as utilised in Canada), where a government guarantee is provided for bonds secured by eligible mortgage pools, with provisions that the lender or originator has a stake through direct investment in the bond, thereby reducing the risks inherent in the pre-GFC securitisation model. Various structures are available to minimise the risks to the Commonwealth arising from this initiative. Appropriately structured pools will expose the Commonwealth to negligible risk, but should form the catalyst to create real competition and promote economic growth while ensuring that the guarantee only applies to its intended target market.

It is important that the major banks do not continue in a position where they can effectively control the home loan market without any real competition or choice for consumers.

We submit that the removal of the bank guarantee in due course in an orderly and timely fashion is an appropriate regulatory and economic response. However, the withdrawal of that guarantee on its own will not of itself solve the problems confronting the finance industry or its end consumers.
Aussie supports policies which promote robust competition and credit market efficiency whilst providing consumers with real choice. We recognise that markets tend to operate most efficiently with little or no government intervention, however the current economic situation where securitisation markets have been effectively shut down makes it desirable for the government to consider some form of support for competitors to re-commence or to increase their home lending and credit activities.

About Aussie

As a leading finance intermediary, Aussie pioneered competition in the home loan market by making non-bank residential mortgage loans widely available to Australian consumers. This was done by sourcing funds from the capital markets through the securitisation of RMBS. This innovative way of funding home loans provided substantial benefits to consumers by way of competition, pricing and product. Importantly, the innovation and competition in the home loan market was achieved without increasing undue risks to consumers.

We would be pleased to provide further information on the above discussed matters.

Yours sincerely

Stephen Porges
Chief Executive Officer