SUBMISSION 5

From: Rob Emmett
Sent: Friday, 4 July 2008 2:51 PM
To: Committee, Economics (REPS)
Subject: New Enquiry into Competition in the Bnaking and Non Banking Sector

Attention Paul Zinkel

Dear Paul

Thank you for the opportunity to contribute our views to the enquiry.

Collins Securities is a non bank lender in the Australian residential loan market. We raise funds through a mix of structured residential wholesale loan programs run by domestic and international banks as well as running our own residential securitised loan program. In order to continue to effectively compete in this market we recently embarked on structuring our own securitised residential loan program. We are in the process of issuing new loans into a pool that will shortly go to market as a rated securitised package. Our business is very well placed to provide an objective view into the challenges that face the non bank sector and margin squeeze being applied by the banks in the market at the moment.

It is important to put into perspective what impact the non bank sector has played to date in driving down the cost of home loans in the Australian market since deregulation of the industry in the late 1980s. Collins Securities entered the market in 1992. At the time bank margins on lending were approximately 4.5% over the cost of funds. In today's terms the relative cost of an average home loan provided by the banks would be in the order of 12.15% i.e. 30 day BBSW = 7.65% plus 4.50%. Today the published Standard Bank home loan rate is in the order of 9.50% although the actual rate struck with most customers who borrow in excess of $250,000 is around 0.70% cheaper than this at 8.70%. The non bank sector has also been responsible for driving flexibility and choice within the sector such as the ability to redraw additional funds contributed to a loan over and above scheduled repayments, line of credit options and much more.

Much of the problem in the current environment has been brought about by the fall out from the sub prime crisis emanating from the US. In short these pressures have led to a freeze in the traditional securitisation markets that banks and non bank lenders use to raise competitively priced wholesale funds to supply in the Australian market. It is expected that the fallout of the funding crisis we are confronted with will continue for at least another 12 to 18 months

In order to increase competition I believe the enquiry needs to focus on 3 key areas

- The spread differential between the real cost of capital vs the Reserve Bank Cash Rate.
- The blow out in term out costs for Australian Residential Mortgage Backed Bond (RMBS) issues.
- Anticompetitive behavior by Australian banks forcing current participants out of the market in the current environment.

<u>The short term market.</u> In order to securitise a pool of mortgages the pool must first be filled up. Short term pricing differes from term out pricing. A typical comparison of pre and post credit crunch is as follows

Costs	Comparative Pre Crunch	Credit Crunch NOW
30 Day BBSW	7.35%	7.65%
Warehouse Margin	0.25%	0.90%
Hard funding Costs	0.15%	0.25%
Wholesale warehouse cost	7.75%	8.90%
Average Loan Rate	**9.00%**	**9.50%**
Risk Margin	**1.25%**	**0.60%**

Notes

1. The spread between the cash rate at 7.25% and the 30 Day BBSW rate at 7.65% has grown from approximately 0.10% to 0.40%. This in part is due to demand by banks in purchasing bank bills to buy back and support their own RMBS issues rather than terming out.
2. Warehousing costs have grown due to normal demand and supply conditions and appetite for money.
3. Marginal increase in servicing hard costs.
4. Banks have made some adjustment to recover some lost ground but haven't gone far enough.
5. The Risk margin includes margin to cover third party commissions to brokers and operating costs for down the line services.
6. New loans secured by banks are written at a rate of 8.80% - being a discount of 0.70% off the standard rate noted above. To compete with the banks in the current environment at this rate a non bank lender would have to write a loan at a negative margin of 0.10%.

Term out market. Once the pool is full loans are then termed out to market. This is the true wholesale cost scenario

Costs	Comparative Pre Crunch	Credit Crunch NOW
30 Day BBSW	7.35%	7.65%
Investment Margin	0.15%	1.50%
Hard funding Costs	0.15%	0.15%
Wholesale warehouse cost	7.65%	9.30%
Average Loan Rate	**9.00%**	**9.50%**
Risk Margin	**1.50%**	**0.20%**

1. Investment margin based on pricing achieved for recent Citibank issue of AAA rated bonds.
2. To meet the market (rate of 8.80%) a mortgage manager must lend out at a negative margin of 0.50%
3. Banks term out in the same market as evidenced by Citibank issue and are taking advantage of their market power by not passing on the true cost of raising new money in the current market and squeezing out non bank players. This is evidenced by a number of lenders exiting the industry in recent weeks.
4. Although this is being addressed banks have been paying exorbitant commissions to brokers at the discounted rates in order to procure business. This generally involves a trailing commission up to 0.30% making it even difficult to attract business in the sector.

Considerations. A number of options need exploring

1. Apply pressure on the banks under ACCC requirements to play fair for new loans and not use their market dominance to squeeze out the non bank rivals. On this basis standard variable rates for new lending needs to be 1.30% higher than they are today or 10.80% (10.10% discounted by 0.70%)
2. Open up access to alternate funding source for the purchase of rated RMBS bonds by a semi government authority. This could be through the future fund at a predetermined and fixed margin.
3. Increase product mix for non bank lenders by opening up complimentary product options

I am happy to discuss and elaborate further with these points.

Kind regards

Rob Emmett | **CEO**
Collins Securities Pty Ltd