



# HEAD OFFICE

Senate Economics Committee  
Department of the Senate  
PO Box 6100  
Parliament House  
CANBERRA ACT 2600

14 January 2011

## **Competition within the Australian Banking Sector.**

### **Submission by Mortgage House of Australia Pty Ltd**

We welcome the extension of time to make a submission to the Senate Economics References Committee's Inquiry into Competition within the Australian banking sector in regard to the release of the Government's paper on the maintenance of a Competitive and Sustainable Banking System.

### **Background**

Mortgage House is one of the largest independent mortgage managers operating in the retail residential mortgage market in Australia. It was established in 1998 and currently has 50 branches located throughout New South Wales, Queensland Victoria, South Australia and Western Australia. We originate residential mortgage loans funded by our own securitised trust, other banks and securitised lenders under our own name and on behalf of major financial institutions. This diversity of funding sources places us in a unique position in being a funder, mortgage manager and a mortgage broker, with a keen appreciation of the challenge of matching borrower's requirements with our available funding resources.

We have \$2.4 billion of mortgages currently in portfolio having originated in excess of \$10.0 billion in mortgage loans, the majority of which were placed in securitised funding programs. Our own funding program is still in warehouse with an anticipated public bond issue in early 2011.

Our submission therefore deals with those aspects of the Terms of Reference that relate to the residential mortgage market and securitised funding in particular.

### **Mortgage Exit Fees**

As a securitised lender our products are structured on a stand alone basis. In general the anticipated revenues from each loan must cover its costs to ensure that holders of securitised debt are paid out in full from the allocated pool of amortising mortgages (created and tested at issuance of the debt securities). Each pool of mortgages is funded by matching debt securities. This contrasts to

the flexibility of a balance sheet lender who uses a portfolio of debt (the components of which fluctuate over time) to fund a portfolio of mortgages. This necessity to closely match the characteristics of the mortgage with the liability becomes a problem for non-bank securitisers. Generally interest rates payable by borrowers are below the major banks' standard variable rate, one of the major points of differentiation in the home loan market. However, there are a number of costs which can only be recovered over time (eg mortgage insurance premiums on each loan, any subsidy related to a discounted introductory interest rate, the administrative costs of establishing the loan). These costs are disclosed to the borrower, with the understanding that, in exchange for a lower interest rate the costs will be recovered if the loan is repaid within 3 to 5 years of settlement. This is an understandable trade-off acceptable to borrowers.

Any prohibition on these fees will inevitably result in a reduction in consumer choice and relatively higher interest rates as loans will have to be structured on a conservative cost recovery basis to compensate for a shorter anticipated average loan life. We believe that the structuring of these early termination fees within the principles enunciated in ASIC's recently released Regulatory Guide 220 (Early Termination fees for residential loans: Unconscionable fees and unfair contract terms) will maintain the benefits of a lower interest rate to those borrowers prepared to maintain a long term relationship with a lender.

### **Support for smaller lenders**

We welcome the support provided by the provision of a further \$4.0 billion in funding to the AOFM for the purchase of AAA rated Residential Mortgage Backed Securities. This supply of funds will provide continuity for smaller lenders and mitigate the adverse consequences of pricing disruptions from forced sales from offshore markets into our relatively thin domestic secondary market. In this regard we are very supportive of moves to improve liquidity in the secondary market.

However the nature of RMBS (in particular the pass-through of principal on each payment date and the diversity of pool characteristics between the smaller issuers) makes each issue unique, compounded post GFC by smaller issue sizes (which limits investor interest). These attributes limit secondary market liquidity for RMBS.

We therefore welcome the support for the development of bullet RMBS securities as a step toward satisfying the requirements of the broader fixed interest market. This would be significantly enhanced if it were to include a Government support of the senior tranche (say from an entity similar to the old HLIC) as to credit quality and/or to underpin a hard bullet maturity.

However, given the superior credit performance of Australian RMBS we believe that the greatest benefit to competition would come from the creation of a uniform, Government backed bullet securities (along the lines of the Canadian Mortgage model) as an overlay of the existing RMBS AAA pass through structures. In one move the Government would significantly deepen the investor base with the inclusion of such securities in a banks' liquidity measure and facilitate superannuation fund investment through incorporation in the fixed income index.

We consider that the elimination of investor concern for the credit characteristics of each issue (allowing the aggregation of issues) and the creation of bullet security are the keys to a long term sustainable reduction in RMBS margins.

We would be pleased to provide further information on these matters.

Ken Sayer  
Managing Director.