



# Non-banks in for the long haul

With the US sub-prime mortgage market crisis already making waves on Australian shores, Lauren King takes a deeper look into how the non-bank lenders are responding to recent criticisms of their business models

Recent comments made by Westpac's chief executive David Morgan calling into question the sustainability of the non-bank model in light of the current credit crisis have left a bitter taste for many non-bank lenders.

Morgan, speaking to the *Australian Financial Review*, mused over "whether these [non-bank] models are going to be sustainable going forward" as "the effect of rising credit spreads to non-bank lenders".

As expected, Morgan's comments did not go down well with some non-bank lenders – a sector which works closely with brokers.

Mortgage House was the first to release a response, quickly refuting any claims by "senior staff at banks" that suggested the non-bank lenders would be forced to increase interest rates above RBA levels. "Despite other players in the market opting to increase rates further than RBA official rises, including speculation from a major bank in relation to low-doc loans, Mortgage House's rates on loans funded through their self-funded program will stay in line with RBA levels," the lender said.

Mortgage House also challenged other non-bank lenders to "stay on par in the spirit of healthy competition".

However, not many of the other non-bank lenders have followed suit on the rates front.

Speaking with *AB*, Bluestone's Peter McGuinness pointed out that the lender had already "adjusted its rates outside RBA levels".

"We've actually already done this, as have most non-bank lenders including Liberty and Pepper," he said. McGuinness said the increase reflected a combination of two factors. "The first is the increased cost of credit for residential mortgage-backed securities (RMBS), which is the longer-term funding mechanism used by many lenders – not just non-banks – in Australia."

McGuinness said that this increased cost is not driven by a deterioration of credit standards or arrears levels in Australia, as it was in the US, but rather "a lack of demand from traditional RMBS investors who are sitting on their cash until such time as the credit markets globally settle down".

"The second factor is the impact of the cash to bills spread," McGuinness explained. "There's a difference between the RBA's official cash rate and bank bill swap rates (BSWR), which is used to price shorter-term funding instruments used by banks and non-banks to fund some or all of their mortgage originations."

"Again, this rate is driven by the supply and demand of available liquidity in the money markets more generally, and in an environment where financial

institutions are hoarding their cash, the 'cost' of borrowing money at the BSWR increases."

In response to Morgan's comments, McGuinness also pointed out that while the current market conditions were affecting Bluestone and other non-bank lenders, banks were not immune. "Money just got slightly more expensive, so while Bluestone is certainly affected by the current market conditions, that would also be true of most banks and non-banks originating mortgages at the moment," he said. "I believe it's only a matter of time until more of the banks reflect their increased cost of funding above RBA cash rates to the customers."

Although head of marketing and product at Pepper Homeloans Ed Thian took a more diplomatic view of Morgan's comments, he agreed with McGuinness when it came to the major banks not being immune. "Clearly he [Morgan] is a very successful CEO of Westpac and I think it would be incorrect to dismiss his comments," Thian told *AB*. "But I wouldn't say that the large banks are immune, either."

"Certainly, there's validity in terms of what he's saying in the context of everybody – rather than, I'd say, purely non-banks – because clearly the major banks are also experiencing some challenges with this increased cost of funds."

Thian said this was evident in the fact that banks such as ANZ, Adelaide and Macquarie had already lifted their rates as a result of the credit squeeze.

"What will happen is there'll be some changes in the marketplace and I think everybody – whether they're large or small lenders, whether they're banks or non-banks – will need to look at the increased cost of funds."

Mortgage Ezy GM Garry Driscoll, however, was blunter, stating he "wouldn't expect Morgan to talk up the non-bank sector as it was the emergence of non-banks that forced the major banks to cut margins on their home loan portfolios".

"This resulted in millions of dollars in savings for average borrowers as the banks reluctantly reduced their rates to remain competitive," he said.

"The banks would love nothing more than to see non-banks disappear so they could slowly ratchet up their rates back to the levels of the 'good old days.'"

Driscoll added that he did not believe the current credit crisis will be long term as "the fundamental issues in the US sub-prime market are completely different from the Australian market".

"It's like comparing rotten apples to healthy oranges," Driscoll explained. "We believe there will be some short-term adjustments to the rates on some specific



**Australian Broker**  
Wednesday 14/11/2007  
Page: 42  
Section: Issue 4.19  
Region: National  
Type: Magazines Business  
Size: 508.57 sq.cms.  
Published: Fortnightly

Brief: MEZY  
Page 2 of 2



products, but the stronger non-bank funders have their own cash resources, their existing RMBS issues and, in some cases, hedging to enable them to hold their rates at current levels until the market returns to normal levels.”



**Ed Thian**



**Garry Driscoll**



**Bluestone CEO Alistair Jeffery with Peter McGuinness**