
Agility agenda

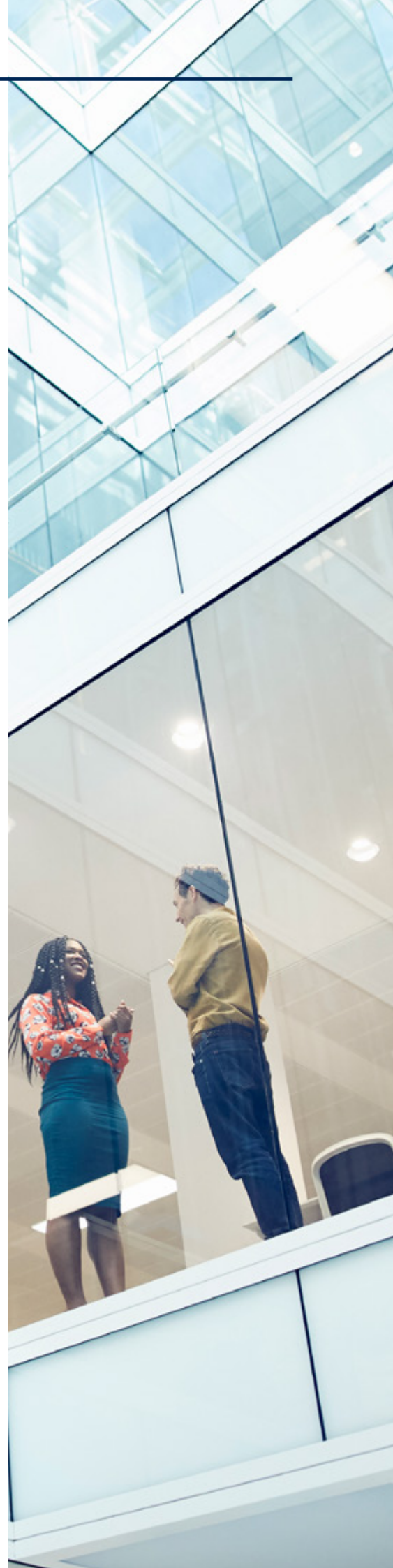
The story of Australia and New Zealand's
non-bank sector: past, present and future



Perpetual 

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Introduction and report scope

Perpetual Corporate Trust (PCT) and the Australian Securitisation Forum (ASF) have conducted research on specific market segments for close to a decade, covering topics such as investor preferences, asset class diversification, the rise of the warehouse and sustainability in securitisation. This year, PCT and the ASF have collaborated on a detailed study of the Australian non-bank sector: *Agility agenda: The story of Australia's and New Zealand's non-bank sector: past, present and future*. The report focuses on the opinions of market participants in terms of the sector's success and how to continue such strong momentum.

The study

Agility agenda collates the views of a diverse range of securitisation industry participants from Australia, New Zealand, Europe and the USA.

With 31 industry participants and many hours of conversation, this report includes the views of CEOs, CFOs, group treasurers, portfolio managers, executive directors, department heads and more. Interviewees represented Australian and New Zealand non-bank issuers, warehouse banks, local and global investors as well as key market participants. PCT and the ASF would like to thank all the contributors who made this report possible. Their time and candid viewpoints are greatly appreciated and give this report both rigour and valuable insight. Participant responses have been relayed liberally throughout the report while maintaining anonymity.

All interviews were conducted by Gary Lembit, Senior Manager Client Insights at Perpetual. Gary was also responsible for writing the commentary in the report. Conversations were free flowing, covering a range of topics with participants able to share personal views and perspective.

PCT would like to acknowledge the generous contribution participants gave in terms of time and candid opinion. Without their generosity, this report would not have been possible.



Richard McCarthy
Group Executive
Perpetual Corporate Trust

Executive summary

Securitisation has been a trusted and well utilised form of funding in the Australian market since its introduction around 30 years ago. While traditional banks continue to dominate lending in the Australian market, since the 2007 Global Financial Crisis (GFC), there has been unprecedented growth in the non-bank sector.

Over the past decade many non-bank lenders have evolved their business model, growing and ever increasing their engagement with customers and intermediaries, whilst their uptake of innovative digital technology has allowed them to be nimble, agile and quickly grow their customer base.

The growth of the non-bank sector

Theories abound as to the factors leading to the success of non-banks in the Australian securitisation market. Four key themes emerge:



1. Access to funding

A significant factor in non-bank growth has been the ability of the sector to continue to access funding. Non-banks have been able to diversify their funding partners and have had greater access and support from the term capital markets due to their strong relationships, quality assets, and consistency of issuance, while we have seen banks issuance drop considerably. Going forward, non-banks will continue to survive and thrive on the strength of their funding arrangements, continued investment in technology and relationships. Warehouse funding is continuing to blossom with domestic banks, global banks and large investors enthusiastic about forming long term relationships with issuers, who meet their quality standards. Large investors are increasingly seeing warehouses as an effective way to access all levels of the capital stack to unlock the value it delivers.



2. Unmet consumer needs

Non-banks have identified market niches where traditional banks were unable or unwilling (for a variety of reasons) to provide funding. Non-banks will continue to find market niches, but it is likely going forward there will be greater competition. Niches come in a variety of forms, rather than being specific to market segments. Consumer experience, confidence of quick credit approvals, settlements and accessibility of products which meet their needs are becoming just as important.



3. Excellent relationship management

A bedrock characteristic of non-bank lenders is their ability to build and maintain excellent customer and stakeholder relationships. The quality of their relationships will be critical to the continued success of their business moving forward.



4. Innovation in technology

The ability of non-banks to introduce technology to make it quicker, easier and more convenient for their clients has always been a hallmark of the industry and is perceived to be a major differentiator between non-banks and traditional banks. This will be a defining factor in the future success of non-banks. The concentration of innovative solutions is spreading beyond origination and the loan approval process and gravitating to holistic management of an issuer's securitisation needs.

Industry insider: PCT's rare vantage point

Perpetual Digital, PCT's innovation company, leverages 25 plus years of expertise and experience in securitisation, data solutions and analytics to help clients and the broader ecosystem, to be more effective, efficient, scalable and economical, while managing ever-increasing cyber security risks and maintaining compliance.

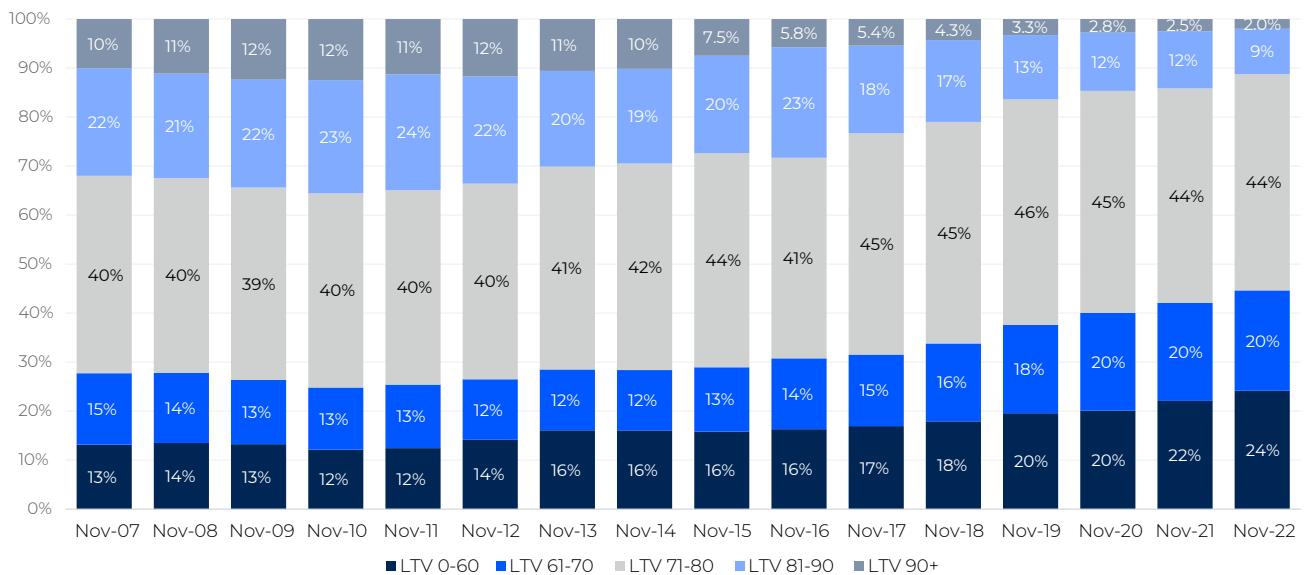
As a data-driven business, Perpetual Digital provides critical infrastructure to the securitisation market, and is regularly at the centre of non-bank transactions.

This provides the company with a rare vantage point from which to overview the securitisation market – which as at November 2022 was tracking at just under \$50Bn*.

As the economy is expected to slow in 2023 and the rapid rise in the RBA cash rate is set to put pressure on borrowers' capacity to repay, the non-bank sector is in a strong position to weather these expected headwinds given:

1. Share of high loan-to-value (LTV >90%) current balances has fallen considerably from the GFC era where it tracked as high as 13% of total current balances in July 2008 to now just representing 2% in November 2022.

Non-bank share of current balances by ltv at origination



*Source: The Public and Privately Authorised Non-bank RMBS data reported to the RBA via Perpetual Corporate Trust, as at November 2022

- 2. Non-banks have an extremely low exposure fixed rate loans which are likely to be of concern for the broader mortgage industry in 2023 as a significant number of borrowers come off the low fixed rate loans that were available during the record low interest rate environment in 2021.

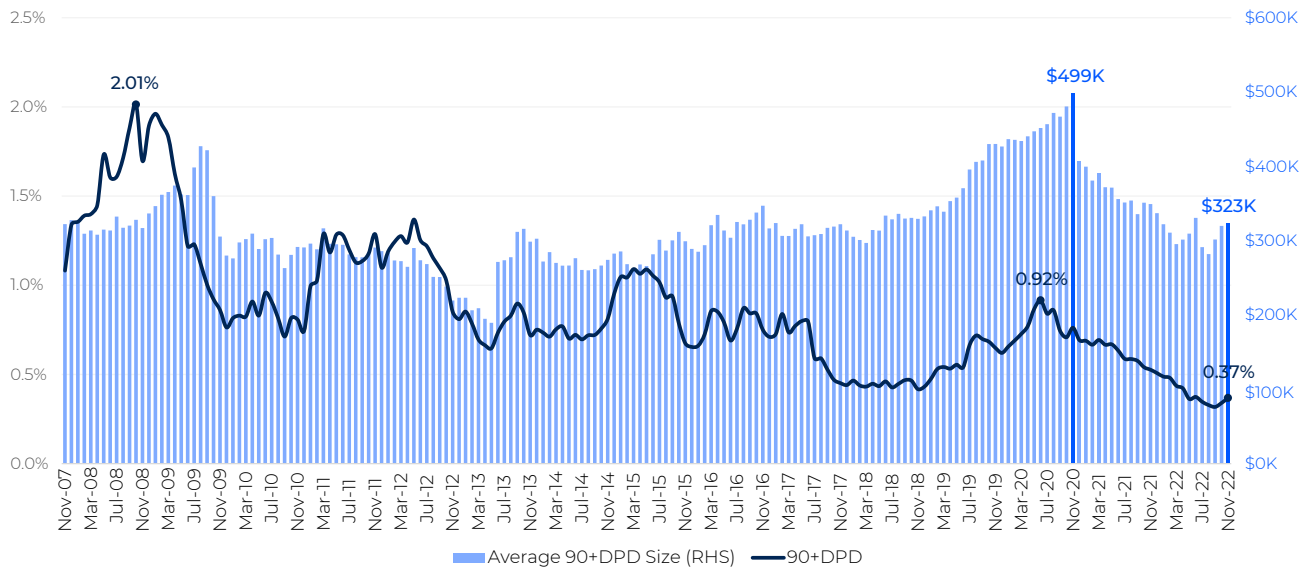
Long-term share of non-bank fixed rate mortgage current balances



*Source: The Public and Privately Authorised Non-bank RMBS data reported to the RBA via Perpetual Corporate Trust, as at November 2022

- 3. Arrears (90+ days past due) for the non-banks are currently tracking at 37 basis points – the lowest level in 15 years.

Non-bank 90+DPD delinquencies as a % of total current balances



*Source: The Public and Privately Authorised Non-bank RMBS data reported to the RBA via Perpetual Corporate Trust, as at November 2022

2023 economic outlook

Prepared by Stephen Roberts, in-house economist, Laminar Capital. Stephen is a graduate of The London School of Economics and has 50 years experience working with leading Australian and international financial institutions, including Barclays Bank, Westpac, Swiss Banking Corporation / UBS, Fay Richwhite, BT, Equitilink, Grange Securities, Lehman Brothers and Nomura. Since 2012 Stephen has worked for Laminar Capital providing regular economic and financial commentaries.

2022 marked the return of high annual inflation pushing up in Australia from an average 2.5% over the previous three decades to more than 7%. International factors were one driver of Australia's high inflation rate including global supply chain disruption in the COVID pandemic and a sharp rise in energy and food prices made worse by the Ukraine war. Local factors also played a significant part too.

With the relaxation of most COVID restrictions early in the year, repressed household spending during lockdown boomed and was assisted by high government payments to households, accumulated household savings during lockdown and very easy monetary conditions.

Essentially, the Federal and State Governments and the Reserve Bank (RBA) expected COVID restrictions to lead to a deep economic downturn and a slow, soft economic recovery beyond and that imbued their highly expansionary policy settings through 2021 and the early months of 2022. Australia's economic recovery proved to be sharper and stronger than expected driven by a big and persistent uplift in consumer spending as well as a strong contribution to national income

from higher-than-expected export commodity prices. Blind-sided by the strength of the economic recovery and the associated marked tightening of Australian labour market conditions, the RBA was forced to make a major change to its policy position in Q2. Repeated guidance that the RBA would continue to provide monetary accommodation to an economy struggling to recover changed to a need to tighten monetary conditions quickly to deal with an economy showing signs of over-heating and generating sustained inflation pressure.

The RBA's first cash rate hike came in May, the first in a series of consecutive rate hikes taking the cash rate from 0.10% to 3.10% by year-end. Lenders passed through the rate hikes to their variable rate borrowers, the first interest rate increases experienced in a decade and the biggest interest rate increases in three decades.

Fixed rate borrowers, while protected from the variable rate increases faced sharp rate increases on rollover with the numbers of rollovers on two and three-year fixed loans written at the height of the housing boom in 2019 and 2020 rising through 2022 and set to lift sharply in the first half of 2023.

While, the higher mortgage loan interest payment shock has been large, the heavily indebted household sector (debt outstanding at more than 200% of household income, the highest ratio in the OECD) has managed to cope so far with a relatively small increase in default rates. Several factors explain the relative lack of deterioration in loan quality so far. Variable interest mortgage borrowers had a substantial buffer running in to the interest rate rises; household savings rose in the pandemic and are still high; household income has risen faster than inflation; employment growth has been exceptionally strong; unemployment is very low; and mortgages extended in Australia are full recourse providing borrowers with incentive to cut back everywhere else in challenging times rather than defaulting on their mortgage.

Looking ahead to 2023, other than softening housing activity other parts of the economy still have quite strong momentum running in to the early months of the year.

That momentum is likely to fade as borrowers continue to experience, with a lag the effects of earlier RBA hikes. Households are likely to be looking for areas where they can cut back spending to accommodate higher loan repayments and the rollovers of earlier 2 and 3-year fixed rate loans as much higher rates peak in Q2 2023.

The run of local economic data including the Q4 CPI reading in late January look mostly strong/high ahead of the RBA's first policy meeting of 2023 in early

February and another 25bps cash rate hike to 3.35% seems likely.

Much will depend then upon how long strong momentum in the economy extending to a persistently tight labour market lasts.

Reasons why demand growth should moderate late Q1 and in Q2 are compelling and should serve to limit the need for further RBA rate hikes beyond February. The biggest risk faced by all sectors of the Australian economy, including the finance

sector, is that the RBA needs to hike interest rates more than is envisaged currently – say above 4% - because inflation fails to recede as much as expected in 2023. Recession and higher unemployment would follow in turn driving up loan default rates.



The state of the market: past performance helps predict future patterns

The current volatile state of world financial markets and the economy provide an intriguing backdrop to this report's investigation into the evolution of the non-bank sector in securitisation. Industry participants acknowledge the stress and pressure of the current market, yet are treating events with hallmark "calm and caution" and see plenty of positive outcomes for the industry.

There is a quiet confidence the industry will continue to weather inevitable storms and capitalise on opportunities inherent in any period of change.

To understand the context of participants views on the non-bank sector (the central focus of this report), we start with their perspectives on the current state of the market, then progress through the rise of the non-bank sector to the present and into the future. Interviews with market participants were conducted in late 2022 across Australia and New Zealand. Our goal is to uncover the factors that have contributed to the success of the sector and assess whether these factors will stand new and established, non-bank participants in good stead for the future.

Spotlight on the securitisation sector

Several pressures are exerting their influence on the securitisation sector, with access to funding, pricing and investor demand the most prominent. Warehouse relationships remain strong, however, capacity is limited and new entrants without a suitable track record will struggle.

Hundreds of millions worth of deals are still being done but the deal size is smaller and they're taking longer to bring to market. Issuers are spending more time ensuring their deal will be supported prior to launch. Many of them spoke about the importance of maintaining relationships over the long term so potential investors are not missed, even if they've been absent from the market.

Newer participants, who have not been through many market cycles, are feeling some tension, created by market uncertainty and exposure to new market conditions. Yet there is underlying optimism amongst participants who have been through several cycles and whose focus is unerringly on the long term.

The primary outcome of the widening of spreads is a single-minded focus on quality as investors shy away from the mezz tranches due to the prospect of real losses.

Interestingly participants are not reporting a rise in arrears but they sense this is coming as interest rate rises begin to negatively impact the borrower.

While RMBS appears most affected by rate rises in the short term, issuers specialising in other asset classes are not yet experiencing much impact on origination volumes. In New Zealand, the housing market has almost come to a standstill but Auto sales are steady and in Australia SME loans continue to flow through.

Moreover, despite the prospect of a reduction in demand for credit, issuers are upbeat about their ability to continue to originate loans at a steady pace. Of greater concern is the ready supply of funding. Issuers claim the relationships they have with warehouses and private funders remain strong but are equally conscious of the heightened scrutiny of their loan quality. The long term emphasis on securing diversity of funding sources is stronger than ever.

Investor demand, particularly for the lower tranches is causing concern for some and ultimately tempering price expectations. Non-bank issuers place a great degree of importance in consistency and reliability of presence in the market and are trading off price to ensure they maintain their presence.

It's volatile, it's a little bit wild out there. I haven't really seen the likes of this in my time in markets. It's calmed down a little bit more on certain days I'd say but yes it's been a very hectic year, a very hectic 12 months. We've gone from pretty much the post GFC type of securitisation markets in November 21 to where we're about to roll into November 22 and it's a rollercoaster.

Warehouse

I think deals are taking longer to put together. Issuers are more willing to be conciliatory to investors and give them what they need and it's a much bigger juggling act than basically putting a deal out there and having two or three people bite your hand off for each and every note.

Warehouse

I feel like there's still a lot of really strong opportunities on the warehouse side and in other asset classes, obviously, we're going to go through a period of increased stress, but I think originators are prepared for it and we've structured our deals to be prepared for it.

Investor

Very, very challenging marketplace for the second half of 2022. I think the first half of 2022 people were kind of forecasting markets to end up a little bit differently to where they eventually did end up and it's caused a little bit of a challenge in the funding space especially when I think when you've got new issuers looking to come to market it's a very different space to what they would've expected a little while ago.

Non-bank

Everything revolves around what's going to happen with future interest rates and inflation and whether it's a real recession or not so the amount of activity in the markets if you compare it to six months or a year ago is definitely down.

Non-bank

'I think it's harder to get certain funding and certain elements within securitisation. So getting to lower mezz and higher detachment points is probably a bit harder or definitely more expensive.

Non-bank

We have a fixed margin over a floating rate and we hedge with an interest rate swap and I think everyone is sort of staring into that at the moment where swap pricing just started increasing dramatically, I think from February, March onwards. That's obviously something that everyone is grappling with.

Non-bank

There were a couple of recent transactions that got pulled. But there's a few coming to the market at the moment, two were announced this week, and I think everyone in the market really needs those to get across the line, to be honest.

Non-bank

Look, obviously, you've had a lot of the offshore bids sort of fallen away quite recently and credit has moved wider. It was extremely favourable for non-bank issuers going back even nine months ago, it was like an all time low, almost back to pre-GFC levels, credit was very cheap. There's broad based nervousness in the markets, inflationary pressures there, you're looking at energy costs, the conflict in Russia and Ukraine and driving instability, globally, it is just creating a heightened degree of nervousness because people are thinking what does the next 3/6/12 months look like? No one knows. There's a more cautious bias there.

Non-bank

You certainly have to acknowledge that the easy breezy days of doing deals are just not there, it's certainly a lot harder.

Non-bank

We try and be pragmatic, if you intend to issue through the cycle, sometimes the price isn't as great as the previous deal, but it is what it is and if you're playing the long game and looking at it over a 5 or 10 year timeframe, well, it will just be a small blip in the scheme of things, hopefully.

Non-bank

I don't believe that any issuer's new deals are struggling because of collateral concerns, rather it is just market volatility and relative value. That is, the fear of catching the falling knife.

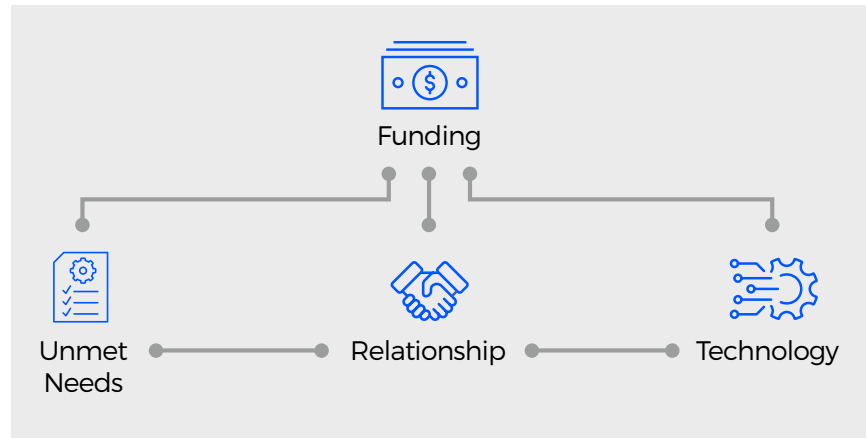
Non-bank

The non-bank evolution

Theories abound as to the factors leading to the success of non-banks in the Australian securitisation market and there is truth in all of them.

Four key themes emerge:

1. Access to funding
2. Unmet consumer needs
3. Innovation in technology
4. Relationship building



1. Access to funding



The pathway to growth in securitisation is typified by the pursuit of ever cheaper sources of funding. Starting with an idea and some capital, many non-banks have followed the traditional path of obtaining private funding, securing their first warehouse and eventually, if growth is sufficiently large, transacting their first term deal.

The fact that so many non-banks have been able to follow this path in the past ten or more years has relied on an abundance of capital at rates that allowed them to compete directly with majors and to capture the attention of investors seeking value.

The willingness of investors to support all layers of the capital spectrum led to new deals being taken up swiftly and prospects for lending across a wider range of asset classes at varying degrees of quality remained strong.

The proliferation of warehouse funding supported this growth.

Behind the scenes, both funders and investors were placing significant demands on issuers in scrutinising their credit quality and lending practices. This encouraged issuers to hone their credit skills and deliver transparency while keeping a close eye on costs.

It was never the case that non-banks had a free ride despite the availability of capital and this led to the steady, ordered approach many non-banks display in generating growth.

Of course, not all have been successful, but those that have respect and value the support of funders and invest heavily in those relationships.

The misconception originally with non-banks was that, they were taking loans that the major banks didn't want to do and that was fundamentally wrong. Really the cost of funding became so low and there was so much capital in the system that the senior lenders as well as mezz were pricing the warehouse lending in the public market loans so efficiently that these non-banks were able to compete on rates with major banks, and then trying to win based on quality of service, and the technology angle, and speed of execution and so they really were successful.

Investor

When I look back at the pools that we wrote at the time, and those early trades, they were largely a combination of high LVR and low doc. So, you know, fairly ... fairly poor collateral. And of course the financial crisis was the major evolution for the business where we really had to change to the super prime presence where we are today. And that was necessary at that time because you just wouldn't be able to find funding post the financial crisis, unless you did have high quality collateral. And so that's what really drove that evolution.

Non-bank

The success of non-banks to date has been driven by their ability to originate, assess and settle loans efficiently and economically, particularly when compared to some of the legacy credit processes at traditional ADI's.

Market participant
Non-bank

We started with a hypothesis that we needed quite a diverse range of funding sources, but we weren't going to be a bank, right, and the appeal there was all around focus and scale. So, in our view, being a bank, and requiring that much capital, just regulatory capital, let alone anything else and then having to build out five or six different products, we thought, much more capital efficient, and much more focused, if we just became a specialised mortgage lender and we went for the capitalized funding strategy.

Non-bank

The appeal of securitisation is that it is one leg of the stool. So, you can be pretty capital efficient in that but we also have the whole loan sale arrangements and we're also exploring other sorts of arrangements to get diversification of funds.

Non-bank

Access to funding through warehouse lines and ultimately term capital markets has supported the growth of non-banks who have also used new technology and systems to provide funders and investors with transparent and real-time reporting on the performance of their portfolios.

Market participant
Non-bank

What you're seeing now is quite well capitalised non-banks that have flexible capital or alternative funding sources or strategies that have helped deliver well above the market credit growth and it's also a function of some of the majors sort of tightening their credit shackles, which meant that some of that volume the banks may have potentially written is now spilling over into the non-bank world and has been doing so for several years and that's contributed to the fairly strong growth from some of those players.

Non-bank

'I think the very low interest rates more recently has just driven credit growth. Generally, I think the regulators have worked to ensure that we've got reasonable competition particularly in the resi mortgage space. The non-banks they're a really, really important part of the market, whereby they're supporting financial inclusion across the board. In the absence of the non-banks we essentially have an oligopoly in the resi mortgage space.

Warehouse

I think also the interest from private equity has been key in supporting the growth objectives of these businesses. The consumer credit culture, and the consumer credit legislation means that the performance has also been strong, even during economic downturn.

Warehouse

2. Unmet consumer needs



While non-banks recognise the critical role funding has played in their evolution and growth, their overriding belief is that their ability to differentiate has laid the groundwork for growth. Many credit their success to finding a niche, albeit the niche can come in many shapes and forms. It might be an asset class, a segment in the population whose needs are not met by the banks, a group whose orientation to digital has led them to lenders with superior online platforms, or even through delivering a brand that aligns with consumer values.

The growth of the mortgage broker network has been a strong contributor to bringing non-banks to consumers. Consumers value the role of an independent and appreciate the time brokers spend in demystifying the process of obtaining a loan and sorting through the options that best meet their needs.

At the same time, the splintering of media and the shift from the dominance of traditional advertising formats has given non-banks the chance to be seen alongside much larger competitors. The clever ones avoid the trap of overspending on search and are finding new and interesting ways of attracting consumers into their orbit.

There was a lot of talk across all participants about the major banks' focus on prime mortgages and their exit from markets and asset classes they once dominated. Auto is the prime example although many talked about banks' restricted interest in SME lending and personal lending.

Importantly, non-banks are confident in their ability to find customers and few expressed any concerns that their ability to originate loans is under threat. Some mentioned an increase in competition in areas they felt were once their exclusive domain but this was not cause for particular concern.

The New Zealand market differs a little from this scenario in that the mortgage market has stalled, non-banks have a tiny share of RMBS, yet prospects to grow their share are bright due to the introduction of changes to the Triple CFA in 2021, another instance in which non-banks are stepping in to fill a gap left by banks. Auto loans in contrast have continued apace through the COVID years although issuers in New Zealand expect a slowdown.

Whether you call it a niche or a point of difference, other challenges aside, non-banks remain confident in their ability to originate a consistent and healthy volume of loans no matter what asset class or segment they come from.

We've done a lot more in consumer finance and autos, which I think are big opportunities. The banks have pretty much given up and conceded a lot of market share. The banks are happy to fund the non-banks in that space at the triple A level in the institutional part of the bank via securitisation rather than compete with them.

Investor

Banks have just decided that mortgages is the main game and that vanilla mortgages that don't take up too much time and resources are the way to go.

Investor

As for the motivation for why banks are pulling back on products like personal loans, I don't know whether it's a credit risk consideration or whether it's due to the impact of the RBNZ capital changes in New Zealand, which don't really incentivise that sort of lending.

NZ Issuer

If you personally go in and apply for a loan, you're going to have a much better chance under your own name than if you had a consultancy and it's a PTY limited.

Non-bank

Almost all of our customers bank with the Big Four, but most of them wouldn't be able to get financing through a bank other than maybe waiting a much longer time period or necessarily having some kind of security behind that lend.

Our market was borrowers who are quite experienced that have had home loans before, that are typically the PAYG, white collar professionals in the capital cities, who know what they're doing. They're quite experienced, and they're able to shop and compare online and they don't need advice, or somebody holding their hand.

Non-bank

There is a fundamental shift that's happening at the moment, and this is really significant to non-banks, that the banks and particularly the major banks have largely exited most businesses, except for mortgages.

Non-bank

We have invested in our brand positioning and we've done so using digital marketing and social and stuff but also some TV and we have taken the opportunity for free publicity but we've now got about 33% brand awareness across the country.

Non-bank

Brokers have gone from 50% to I think about 70% of the market, and the brokers are going to be less brand sensitive, and they're going to be more willing to sell propositions to the customers that maybe the customers haven't heard of yet. So, the power of broker distribution probably also has helped the non-bank sector as well. I think there's a crop of brands that a new generation of consumers are willing to give a go to.

Non-bank

Banks have been pulling back for about a decade on a lot of what they would've typically considered on the fairways for them.

Warehouse

'I think the world through social media has become very...everything has to be self-gratification, right? I want the answers now. Whether it's watching the two second video, or it's applying for a mortgage, and not having to wait more than 50 minutes to determine your outcome, and I think you're starting to see it a lot more on the mortgage side and you're going to start seeing it a lot more on the personal loans and credit cards and all that.

Non

Beyond the satisfaction of unmet consumer needs, the ability of non-banks to introduce technology to make it quicker, easier and more convenient for clients to obtain loans is perceived to be a major differentiator between non-banks and traditional banks. There is a view that legacy systems hamper banks' ability to deliver a smooth application experience and a reliance on manual methods for assessing applications adds significant time to the loan approval process.

In terms of the value of technology as a contributor to the evolution of the non-bank sector, the emphasis has been almost exclusively on origination. While technology is likely to play a more substantial and diverse role in the future evolution of the non-bank sector and the securitisation market more broadly, until now origination has been the almost single minded focus.

The ability to approve loans faster came at a time when the mortgage market was particularly dynamic and fast approval often meant the difference between getting the house or not.

Technology will be one of the key differentiators enabling non-banks to compete with ADI's, primarily because efficiencies gained through technology and digital solutions across the value chain from origination, credit approval, portfolio and client management, funding and reporting will enable non-banks to drive scale.

Market participant

There's a lot of tech and CapEx spend that the banks can't keep up with. So they've kind of conceded in consumer auto finance, they're not going to compete on the service and tech offering to compete in that space, really happy to still write their legacy products but they're not really going to innovate as much on those products and so the non-banks have capitalized on a relatively big opportunity for them.

Investor

We followed on with digital distribution, retail direct to customer, and that was a key way to find that really high quality prime collateral.

Non-bank

The change in the macro-economic environment of increasing interest rates, a slowing housing market coupled with highly leveraged borrowers is driving a shift in digital transformation in the middle and back office of the securitisation model. Non-banks are seeking to adopt digital first operating models to create a continuous flow of data interpretation, automation of transaction processing as well as transparency about how and why calculations, models and decisions are generated.

Market participant

3 Innovation in technology



Digital operating models are underpinned by technology platforms connecting stakeholders and integrating, previously manual, components and use cases. Progressive thinkers in the market have already shifted away from unstructured operating methods to platform-based solutions to automate end to end management, portfolio funding, optimising pool selection process and portfolio benchmarking to effectively manage the cost of funding.

Market participant

The last time we had an ASF conference, which is three years ago now, that was all about the fintechs. And it seemed like the average age in the room dropped quite a bit. What those fintechs have brought is some good growth technology. Some great ideas. I think this is fine, not sure why it's not clear.

Non-bank

The reality is that if you don't have legacy systems, and you think you've got a unique origination channel that provides enough loans, it's a lot easier setting up the current operational infrastructure to run a lending business these days and be more responsive to your customers. So that plus banks retreating in different ways, means that that non-bank market continues to grow.

Warehouse

Non-banks tend to have newer systems or more efficient origination processes and given the market at the time, a lot of properties weren't even getting to auction. I think that's certainly benefited the non-banks.

Warehouse

4 Relationship building



Non-banks have always prided themselves on the quality of service provided to all of their stakeholders from borrowers to lenders to investors and this continues to be a consistent focus today.

Issuers have always been conscious that track record means a lot in securitisation and that has led to a desire to hold a consistent presence in the market whether their issuance cadence is one a year or once every two years, the consistency of issuance from non-banks has been a feature of their successful evolution.

Over time their deal sizes have grown as well. But it's the work being done between deals with funders and with investors that has stood non-banks in good stead particularly now in challenging market conditions.

A general policy of letting investors know what they are doing, how their investments are performing and what their plans are means that both regular and sporadic investors keep non-banks in their minds.

Similarly, being open and transparent with data and giving both warehouses and investors free rein to undertake their own assessment of the quality of

their books has helped the non-bank market to tick along in these turbulent times.

It has certainly helped that many of the people in and behind the non-bank sector bring plenty of experience with them.

We've come back to market every couple of years with a deal, our deal sizes have slowly increased, although still not very large compared to Australian standards.

NZ Non-bank

Since our first deal, we've completed one a year for five years, and as we've grown, we've generally speaking increased the size of our deals except for this year with conditions a little bit harder.

Non-bank

There's a bunch of things here around service and flexibility and solutions and some stuff around the banks themselves stepping back or tightening a little bit that has led to the nNon-bank growth.

Non-bank

Non-bank portfolio performance and arrears statistics are reflective of the strong relationship management across non-bank portfolios, providing investors with the confidence to support their term deals.

Market participant

Most issuers talk about the service proposition and I think that has definitely been a feature particularly over the property boom and credit boom that occurred over the last couple of years, we saw some of the banks' service levels, their application times and approval timeframe, really fall apart or really drift out. I think that definitely played to the advantage of non-banks.

Warehouse

'There's a large investment in both people infrastructure and knowledge base that is required for investing in securitisation markets and so as we continue to leverage up on all of those things we've been able to extract more and more value out of the space and we've grown with the market to some extent as well. I look at issuance levels back in 2010 and 2009 and they weren't very high but we're in a different kind of step change from there so that has allowed us to grow as well.

Warehouse

Challenges that may shape the next evolution of the non-bank sector



If we consider the primary factors participants have suggested contributed to the growth of the non-bank sector it is interesting to note that at least one and perhaps two factors, may also be inhibitors of growth in the short to medium term. Funding is clearly difficult in the current environment and there are differences in opinion as to whether this will be a long or short term issue. Participants who believe a global recession is imminent expect funding to be an issue over the longer term while others who perceive a recovery, at least in Australia, are less concerned about funding pressure.

A key challenge for non-banks is increased funding costs and probably higher arrears and losses coming but then I think there's also a challenge of being able to raise equity to support the growth. A number of the listed guys have pretty good loan books, but their share price has been hammered pretty badly and so it's difficult for them to get growing pretty quickly. They need to issue equity to put into the warehouses and the term deals. So we're a bit worried about the longer term health and the corporate balance sheets, more so than the actual receivable pools.

Investor

If your net interest margin is being squeezed it means less profits starting to come into the corporate which is a challenging environment for any corporate to navigate.

Investor

You want to know that the money that you're using to write your loans and keep your business ticking is stable and not going to disappear on you. If you've got really flighty capital, it makes it very difficult to build a business around money that might disappear tomorrow.

Investor

We nearly went public and if we had done that, it'd be an absolute disaster for our company.

Non-bank

A key challenge for the future of the sector will be cyber security and data management. We will continue to see organisations not only harden their security armour, but also increase their focus on data governance. This is because it is key to have systems and processes in place to understand what data you hold, the purpose of that data, who has access to the data and how many versions of the data exist.

Market participant
non-bank

I think the hardest thing for an issuer to do at this point in time is to get certainty on their capital funding requirements or their capital needs. That seems to be the absolute hurdle that everyone's kind of shooting for at the moment.

Investor



This is the sandpaper in the market, we are staring into this reality at the moment where maybe six months ago, funders were happy to have unlimited capacity in warehouses, because there was the expectation that would clear up through a term deal and now everybody's sort of holding on to a little bit more dry powder to support their funders in warehouses and there are definitely questions from funders around when's your next term deal and so on. So it is tricky. It's a tricky time in the market.

Non-bank

We've seen banks be reasonably facilitative in increasing warehouse programs but we do sort of hear on the grapevine that there's some capacity restraint. There's some capacity constraints around how much bigger those warehouses can get. On the flip side we fully expect credit growth is now moderating and originations are definitely coming off. So that should take some of the pressure off some of those warehouse transactions, which were starting to look pretty full given the smaller deals that were hitting the term markets.

Warehouse

Particularly for the non-banks, the mortgage originators, diversity of funding is really critical for them to be able to continue to grow. I think the non-banks need to be very focused on liquidity management, they need to be thinking about ensuring they've got sufficient headroom in their warehousing and they've got to be able to continue to access capital markets, refinance those assets, and free up warehouse capacity sort of wherever they can, and they need to be thinking about diversity of their investor base.

Warehouse

Increasing interest rates have also been a problem for fixed rate lenders in not making securitisation who rely on swap rate, swap markets to hedge their origination that's been a very difficult needle to thread over the course of 2022 we've had just a massive change in swap curves, big moves over short period of time which has caught quite a number of originators on the hop.

Warehouse

The extent to which new niche markets and segments will emerge in the short to medium term is questionable. There are under-served asset classes such as SMSF but volumes in ABS continue to be relatively small other than Auto. Issuers are seeing increased competition from peers and the days of enjoying exclusive commitment from a niche segment are fading.

There were several comments noting the retreat of major banks from a range of asset classes and what seems to be a single-minded focus on prime RMBS. This too is creating short term opportunities but there is no guarantee the majors will not return to sectors if they become increasingly attractive.

Banks' cost of funding hasn't changed because the deposit rates haven't gone up. So in the prime space, at least I'm talking RMBS here, you're now seeing the banks almost fight back and origination for non-banks become hard.

Investor

We put an awful lot of value in our brand. We're really starting to leverage that brand on the origination side and we want to be able to maintain that on the funding side as well.

Non-bank

'The threats, then is that because the banks are being herded into mortgages alone by APRA, they largely have to compete and own that market. And, in particular, the owner-occupier less than 70%, where that's now very advantageous capital weightings. And so the competition is like nothing we've seen before in that market. So non-banks are finding niche areas where they can have some very good opportunities. And, you know, in our case, that particularly is auto & SMSF.

Non-bank

There are questions about whether non-banks can sustain their growth trajectory given that the mezz market is relatively closed.

Non-bank





Non-banks' focus on relationships with all stakeholders will stand them in good stead and there is evidence to suggest their exemplary service to borrowers, funders and investors is only getting stronger. With an issuer's track record being a significant factor driving funder and investor willingness to do business with non-banks, it is natural that established issuers can benefit from relationships they have built over time.

New entrants will have to prove themselves first so are unlikely to gain particular benefit from their approach to engagement and relationships in the short to medium term.

'We're leaning towards steady as she goes, originations are really, really strong and so our need for funding is still high and I guess our default position is that we would like to be returning to market at the same sort of cadence as what we have, historically, regardless of what the pricing is. We'll be there to meet the market and as an issuer we'll ride out the ups and downs just like our investors do.

Non-bank

'We recognize the value and respect of the investors that have supported us in the past. We last issued in 2021, and got really, really good pricing for that. Now, obviously, the pricing has pushed out significantly wider, but we've met with a number of investors who have expressed interest in another transaction and even though the price point is higher we're keen to come out and offer that product to them, because we still see the demand being there for it.

Non-bank

The securitisation market, like a lot of funding markets, is either open or it's closed and there are points in time where the securitisation market is closed and then you've got to make sure that you have either a deep relationship with your warehouse financiers, or other kinds of funding lines like P & A agreements or white labelling.

Non-bank

So really, for us, it's having an objective around what we want to do and what we want to achieve. In this way when we go to a term deal. Is the primary objective to reduce the funding cost or is it really to create funding capacity again, in the warehouse?

Non-bank

So we know the Australian market, the domestic market, has a ceiling on how much it can absorb. So they've really got to be developing those relationships with investors offshore, but they've also got to be thinking about alternate funding sources and that might be, for example, through whole loan sales, for example, or perhaps it's private placement style transactions because the non-bank mortgage originators particularly are very, very reliant on securitisation, they don't have as many tools in their tool bag as it is, when it comes to diversity of funding sources.

Warehouse

This leaves technology as a key driver of medium term growth in the non-bank sector. While non-banks have cleverly exploited technological innovation in origination there are few making the most of technology across other aspects of securitisation. Both funders and investors value transparency very highly and this is magnified when it comes to the supply of data and reporting.

Issuers who innovate in the timeliness and quality of data they provide and the ease of integration with funder and investor systems will hold an advantage. Similarly, their ability to use digital methods for managing, monitoring and servicing their loan books could also lead to a competitive advantage. However, success in these areas could also make them prime acquisition targets.

The challenge that we've been having over the last three months is settling the volume of loans that we've got coming through the door and so we're doing a major overhaul on our tech side of things to upgrade the platform to try and improve the capability to handle that volume.

Non-bank

What we are seeing over time is banks are upgrading their systems, they are buying niche technology players, or they are deploying technology platforms and what we are seeing in that case is that we're seeing them competing much more on that service component which is very much about having the technology to meet that.

Non-bank



Success factors



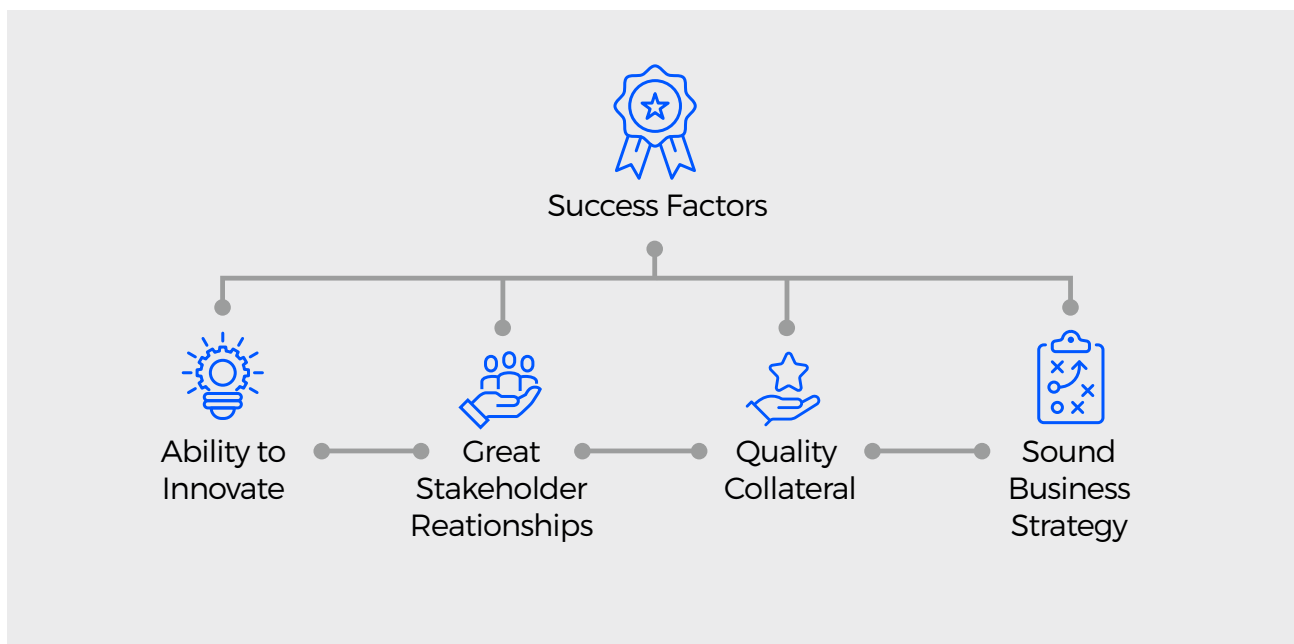
Although it is difficult to predict the future, participants had little trouble describing the characteristics of successful non-bank issuers. Participants feel issuers displaying these characteristics have a much stronger chance of sustainable success. The unknown, future variable is the extent to which current difficult conditions prevail and how long it will take before more normal conditions return.

Non-banks listed a range of factors they believe are necessary for success. These factors can be broadly grouped into the following criteria:

1. Ability to innovate
2. Great stakeholder relationships
3. Quality collateral
4. A sound business strategy

Warehouse participants added a couple of factors to the list:

- Track record
- Experience and partnership



Non-banks attribute their success to quality of underwriting and their ability to differentiate with the borrowers they choose to serve. They believe these factors will continue to serve them in the future.

They point to the performance of their assets as proof of their ability to write quality loans across the capital spectrum. Similarly, demand for their credit does not seem to have abated despite rising interest rates and the difficult economic conditions.

This is in some instances due to the asset classes they operate in where credit needs are not met by ADIs and where demand has not been affected by economic conditions.

Ultimately, that's the proof that's in the pudding, funders can come in and look at your processes, they can hear your pitch, and all the rest then they can see the pool parameters but what they want to see is the actual arrears performance and particularly through a stressed environment. That's where we've had a really strong story.

Non-bank

Non-banks pride themselves on their ability to originate and they credit their success to satisfying unmet needs or making the process as quick and easy as possible for the borrower. Their utilisation of technology to facilitate the application process and generate swift decisions gives them a significant advantage over anyone using antiquated systems with a high degree of manual intervention.

They are also highly focused on their distribution network and in RMBS in particular, make great use of the broker network. For those operating in areas not serviced by brokers, several are using above the line advertising.

Brokers want to be able to talk through a deal, be in the tent not out of the tent. The proposition in terms of the relationship with brokers and putting broker needs up there with your own is what makes the difference.

We've got fairly high approval rates, and it's not because our credits are loose, it's because our distribution partners are well educated in the types of products which we are able to write and want to write and that takes a bit of time to do as well.

Non-bank

However, the challenge of funding for growth is uppermost on non-bank issuer minds. They are responding by increasing their attention to funder and investor needs and transparency and proactivity are top of the list.

The way to run funder relationships is to have an ongoing dialogue with them, there's no surprises that we want to put in front of anybody so we're not having different conversations to even six or 12 months ago or even two years ago.

Non-bank

They are also cognisant of the importance of quality and performance and point to their track record of strong performance being a result of very close relationships with borrowers that allows them to anticipate issues well in advance of them creating problems. They believe this is a key reason for low levels of arrears across the sector despite operating across the capital stack.

Quality, quality and quality rates highest, you've got to have a quality loan book and I keep on saying it's easy to write loans when the market is high and the economy is growing, because you're definitely going to have a higher collectability or lesser delinquencies with a thriving economy but when things go south, that's when your credits and all the enhancements that you've made kind of shows through.

Non-bank

It's really down to the quality of the asset and I think the COVID experience was a really instructive one, because in some ways, it condensed the 25 year business cycle into two years in terms of just the stress that the system was under, and so for us being able to demonstrate like super high quality, really, really high quality through that very stressed period, really gave us a shortcut to credibility with a broader set of funders.

Non-bank

Beyond their strength in origination and single-minded focus on relationships, some non-banks cite their planning practices and their ability to focus on and achieve, key objectives as a major reasons for long term success.

'You've got to have an objective and then you stick to that.

Non-bank

We've made a conscious decision as a business to focus on product profitability this year and so we've also made a conscious decision in line with that to slow down originations a little bit.

NZ Non-bank

Warehouses and investors are highly conscious of the governance of non-banks, they pay particular attention to management and business structure. Warehouses and investors say the first criteria they review when dealing with non-banks is their business' track record and whether it is affecting their current orientation to more established issuers.

if maybe someone showed an interest in a previous deal, but then said, "oh, we're not happy because of X, Y, Z", then you make sure you add them to the reporting and show them that the deals actually performed well. So at the end of the day for me it's actually doing what you say you got to do.

Non-bank

Similarly, warehouses in particular are rarely, if ever, opportunistic, as their notion of relationships is closely akin to a partnerships model. A key reason for this is warehouses are objective-driven and look to issuers who can help them meet those objectives.

Those issuers that are a little bit more established, that have a demonstrated track record is something that we look for. We're not going to be the first bank providing warehouse funding to a newly established issuer but, outside of that, what we look for is an alignment of values.

Warehouse

We do look for those sorts of clients that value a long term partnership, as opposed to those that it's just more opportunistic or looking for the cheapest funding, and would terminate the relationship when they got a better offer from a pricing perspective.

Warehouse

There are issuers that are more developed, more established, larger and have better access to capital at the corporate level not so much from the securitisation level. Those that are profitable and therefore able to weather the storm certainly look a lot better now than some who are newer, more capital intensive, capital hungry.

Warehouse

Funding



The path to securitisation is well trodden and there is little to suggest this traditional funding path for new issuers is likely to change. However, there are significant headwinds for new entrants due to the current state of the market and it will be difficult for many to get traction in the short to medium term.

Access to funding was the single most cited challenge facing the non-bank sector right now but there appears to be little change to the general approach of both non-bank issuers and warehouses to funding and funding relationships. Non-banks have always been conscious of the needs of funders and have developed strong, long term relationships that are standing them in good stead right now.

They have noted a slight increase in scrutiny of loan pools and the odd question about projected origination volumes as warehouses actively seek to limit unused capacity. The truth is that warehouses have always spent quality time evaluating the assets that non-banks present to them (as have investors).

There's a kind of fundamental analysis around what would you and wouldn't you lend to at any price? You need to be able to make sure that for anyone to make it to the next step, it has to be a robust business model. The quality of the sponsors backing them, particularly for the newer businesses that are potentially trying to work their way towards a breakeven point. The type of lending that they're doing and why their processes and how they process not just kind of process and underwrite credit, but then deal with collections and arrears and all that kind of fundamental things to understanding of a lending business and particularly for those kind of less established lenders are ones that are carving out a new niche, what their path is to a level of profitability.

Warehouse

'We're certainly looking at it from increases in the RBA cash and we're definitely looking at it from a servicing perspective. A lot of the deals that are coming to market at the moment in the RMBS space, hit peak valuations on a national basis around March or April this year. So one of the deals that has been hitting the market at the moment, it's been done at a combination of pretty much peak valuation and record low interest rates and so when we look at some of that collateral and when we sort of retest it based on interest rate rises using the debt servicing ratios that are provided to us by the issuers we're certainly spending more time looking at servicing buffers, looking at how quickly they are being increased and looking at how much of the portfolio has been written at peak valuation and record low interest rates.

Warehouse



I would say there's more questions at the moment and those questions are around two things, mainly around pricing. What are you doing with pricing? Are you increasing pricing quick enough on the front book? That's one of the questions we face and that's probably the main question we get a lot of questions around. We get a lot of questions from not necessarily funders, but other stakeholders around hedging. They want to understand hedging.

Non-bank

'Hedging is a topic on everyone's mind, but not from funders. They obviously get it. But people like shareholders, or just generally people within the business, they want to understand hedging a lot more and not just around the protection but also just generally around contracts. For the people that are not close to it, it's a bit of a black box for them, and they wouldn't understand it, because it's seen as a weapon of mass destruction and derivatives, but obviously in the way that we use it, it's a very safe and very, very conservative product.

Non-bank

Demand for funding continues apace as non-banks rely on funding for growth but with spreads widening there is a lot of pressure in striking the right pricing. Several non-banks concede it is necessary to compromise on price for the sake of long term relationships and realistically they don't have a lot of choice in the current environment.

Sometimes we'll have a business that we think is a good business, but they'll have unrealistic expectations around what kind of credit enhancement they should have in the warehouse, and or where they think the price should be.

Warehouse

Despite pressure on pricing, the number and size of warehouses is increasing to meet demand from non-banks. A lot of the demand is coming from issuers specialising in assets the banks either have traditionally avoided or have chosen to walk away from.

Larger investors are setting up their own warehouse arrangements with issuers as this can give them access to value across the capital stack that can be difficult to find in sufficient volume in the term market.

As we get larger and larger it is harder to get the sort of volumes that we need to make some transactions worthwhile. I think for us in a private deal, given we're able to sort of invest across the capital stack, we definitely are able to get much better volume trades and completely with warehouses.

Warehouse

Many felt there were real benefits in operating as a private company and accessing private capital, particularly when issuers who have listed have struggled.

Obviously increased funding costs and probably higher arrears and losses coming but then I think there's also a challenge of being able to raise equity to support the growth. A number of the listed guys have pretty good loan books, but their share price has been hammered pretty badly and so it's difficult for them to get growing pretty quickly. They need to issue equity to put into the warehouses and the term deals. So we're a bit worried about the longer term health and the corporate balance sheets, more so than the actual receivable pools.

Investor

Successful non-banks are conscious of the importance of diversity in funding sources and there is a lot of talk about the real potential for existing funders to pull back. Few non-banks are complacent about their access to funding.

We've got reasonable liquidity debt, but the intention for us as we diversify further into some of the other product types is that we will need new capacity for those products.

Non-bank

Now more than ever, non-banks' dominant focus is on engagement and relationships with warehouses and funding partners. They are also focussed on enhancing the timeliness and quality of the data and information they provide to meet funder needs. Transparency was the most common need expressed by warehouses from the issuers they want to deal with.

'The other question is more questions around our origination forecasts and I think funders are allocating limits between different programs and different borrowers and once you make sure you know that people aren't just asking for a bunch of capacity without really needing it. So they want to see your origination forecasts and obviously does that make sense?

Non-bank

Funders want easy access to management, that you're responsive, and you're transparent.

Non-bank

With pricing tight and access to funding no longer quick and easy there is a heightened focus on precision. Issuers understand funders' need for transparency and do their best to give funders and investors what they need.

Non-banks also value the relationships with ADIs who are happy to provide funding to issuers operating in asset classes the banks have turned down. It's interesting that an issuer's relationship with their first warehouse is much like the relationship between a small business and the bank that gives them their first loan. Those relationships often last forever.

We do a really good job of updating our main wholesale banks and funding partners though, and I think particularly when COVID hit we were very proactive in letting them know how things were going and so I think to your point those relationships are really important.

Non-bank

We've done a lot more in consumer finance and autos, which I think are big opportunities. The banks have pretty much given up and conceded a lot of market share. The banks are happy to fund the non-banks in that space at the triple A level in the institutional part of the bank via securitisation rather than compete with them.

Investor

Despite a lot of work being done to establish strong relationships with funders, there is a common view that consolidation in the non-bank sector is inevitable, particularly as non-banks often bring technology that is attractive to established larger players with legacy systems. Similarly, loan books can be attractive to investors.

One of the themes of the ASF conference was that people are expecting somewhat more robust conditions from a credit quality perspective over the course of 2023. That will have a knock-on into access to funding. Whether it happens in 2023 or 2024, there is obviously the prospect for some consolidation in the non-bank sector and there has been a vibrant growth story over the past five or six years in terms of the establishing of platforms, but it could be finding as a sector that competition weeds out some of the smaller players.

Global Investor

We like warehouse investing, because even if the originator disappeared from the face of the earth, it's a bit of a pain in the backside to manage out the loan pool but from a credit perspective, it's pretty robust.

Warehouse

Technology: the key to the future



For several years we have been asking securitisation participants about the role of technology and its potential for innovation in the sector. There are numerous reasons to believe that in the next few years the role of technology (in all forms) will become a critical differentiator driving the success of those who make the most of it.

At the mention of the word technology it is interesting that most participants think about innovation in origination and that makes sense when you consider so many non-bank issuers have been very successful in making the loan application and approval process more efficient and borrower-friendly. But it's the less utilised capabilities of the digital revolution that may be the differentiators of the future.

It's very easy when everyone's clamouring for your deal to just send out a spreadsheet and you'll get bids but when times are a bit tougher if it was easier for people to do the work and more seamless then maybe you'd be able to find that marginal investor that would be the difference maker.

Warehouse

There are four key themes non-banks and their funders point to when describing the potential for technology and how it can meet their needs.

- Origination enhancement and auto approvals
- Managing, monitoring and reporting
- Holistic digital enablement
- Blue sky potential

There are those who feel there is more value to extract from origination systems particularly when it might be possible to remove the human from the equation. This type of thinking has its critics though and there are many in the industry who feel the human touch at the pointy end of the loan approval process

will always have its place. Others believe the explosion in the ability to access credit data about individuals means automated systems are better placed to make objective decisions and will therefore produce higher performing loan books.

'The biggest thing here is scalability of process. I think when you start to look at more and more issuers, or when your portfolio starts to grow pretty significantly, what you start to look for is the ability to run processes quicker and more dynamically. If you were to wind back the clock, two or three years to run a ratings report or to get an understanding of exactly what something was rated, it would have taken us about three or four days to get a really good understanding of the risk. We are effectively by programming those things through specific programs, we can do that in under a few hours. So you've really been able to shorten up the timeframe to understand the risk of a particular trade. I think, when used effectively and when used to enhance process, technology is a beautiful tool and its scalability benefits tend to be overlooked.

Investor

'It's also the future for us to analyse how well our models are working without like I'm not trying to be like a futurist, but without human interaction and also we can see how that operates free of bias whatsoever.

Non-bank

There is a growing belief in the importance of systems to monitor, manage and produce reporting for securitisation, particularly as both investors and warehouses are managing multiple investment pools. A lot of the work continues to be done using spreadsheets and invariably requires resourcing. Non-banks too can see the benefits of better systems. The increased reporting requirements of funders and the need to proactively service borrowers both give rise to the value of having systems that make it easy to extract data and display it in easily digestible form.

So it's very easy to get great data out of the system and funders appreciate that, because I can show them if they have a question around something, I can pull data together for the last five years in lots of different ways, and be incredibly responsive. So technology is a huge part of what we do, and helps tremendously in the process.

Non-bank

'It's data intensive from our side and obviously it's data intensive from their side so if you don't have the right systems in place, it's pretty much a deal breaker for us, because you just can never be exactly sure what's happening underneath the hood.

Warehouse

So the more data we have in that warehouse, the better our ability to understand and compare is across different lending types.

Warehouse

Technology is just one of the tools, you need warm bodies to get stuff done.

Non-bank

There are rare but no doubt a growing number of non-banks who recognise the value of a holistic approach to securitisation management making the most of digitally enabled tools. There are real examples of non-banks who have digitally integrated every aspect of their business from lead management to loan origination via online application, to monitoring and reporting and communicating with funding partners and investors.

'This is a core of what we do, right. So, let's talk about sort of throughout. We've got an internal platform where the data persists all the way from the lead through the application and origination process, through the servicing, and then back to the funding platform and that enables us to do a really high degree of automation and efficiency in the origination. So, that's efficiency, but also conversion piece and then on the funding side it's also important, we've got a really seamless way to manage the way in which we track the equitable owner of our loans on our platform, so we've got a single servicing platform but on that platform, obviously, loans are tagged to a dozen different funding vehicles, and all of the recording that sits out of the back of those is able to be done very seamlessly.

Non-bank

We've had a brand spanning new data warehouse built and all the dashboards and analysis has been built off the back of that both for internal stakeholders whether it be through a treasury or funding went through even through an operational efficiency lens. So that distribution channels just give them insights as to the speed efficiency of which the deals work through the credit queue and things like that. So it's been a big focus for ours.

Non-bank

For each success story there is another born from frustration. Warehouses and investors continue to find that getting loan data from issuers never quite fits the systems they use and there always seems to be a need for manual intervention. There is also frustration at the lack of truly standardised reporting.

'Like when you're trying to jam data into a system that's really meant for a closed pool term deal. So we get inspired to survey the market and look at what we could do to remove a lot of the manual processes that we have in place but ultimately, we can never find anything that ticks off each of the issues that we have.

Warehouse

Some participants are cynical about the potential for technology and digital tools to create substantial change in the way the industry operates, however, these views are slowly being overtaken by those who can see the potential

'We still are very highly reliant on whether it's cash flow, modelling a transaction or running portfolio level stresses or asset level stresses, we're still highly reliant on Excel worksheets.

Warehouse

when we investigated systems, the problem is they don't cover ABS so non-resi or they can't apply asset level stresses. So there's sort of single rep line or top down sort of models, which is not what our investors want or they're just not very good for warehouses, where you've got a revolving pool of assets.

Warehouse

'I think Excel has been the backbone of a lot of people's ability to use technology for a long, long period of time. I think my personal view is I don't really see that changing anytime in the very near future. I think it's going to be a lot longer timeline to get rid of Excel than anything else.

Investor

'We don't want to auto approve a massive percentage of what we do. Approve what we can do quickly but do it in the most efficient way possible. Don't want to be a in a computer says no kind of world.

Non-bank

A small cohort of industry participants believe there are significant opportunities to innovate in securitisation utilising technology and digital tools and systems. The real change in 2022 is the enthusiasm industry participants display when discussing technology. It has gone from being mildly interested in what someone else is doing to being very interested in how it might benefit their own business.

It's almost become expected of non-banks that they would try to be at the cutting edge in everything they do from how they manage securitisation to how they onboard new customers and do their credit approval process so that bar has been raised pretty high.

Warehouse

'Look, I guess I would probably still come back to the evolution of originations and digital originations. And what we're working on at the moment is part of our big data. And using artificial intelligence, data robots for working out, because digital origination is all about a giant funnel. And you can waste up all your resources focussing on the large amount of leads that come down the pipe, but using AI to work out where your resources should be put to get the maximum ... the maximum efficiency of your spend, and therefore best conversion rates.

Non-bank

Anything that can assist in producing pool cut strat tables and automating that process is hugely helpful. This is a bit off topic, but something I've been thinking about for a while. KYC is an absolute nightmare, no matter where you go and if we had a single repository, whereby companies can supply all of the necessary KYC information and then those parties that need to go through the KYC process for that particular entity maybe they just pay a fee and they get the approval from the company in question, and they can access all the information that they need from the central repository, because all the information is basically the same across all of the banks that need it rather than the issuer providing the same information to 15 different banks or other counterparties. It's a far easier proposition if it's all there in a single source.

Warehouse

Additional insights

ESG

The feedback that we got was that APRA had told the banks, they were concerned about greenwashing and so ESG has got a bigger focus in banks generally, because they want to be doing the right thing and not just ticking the boxes.

Non-bank

We get a lot of questions on ESG from investors and from banks, but also as a real growing push and desire internally to really try and make a difference here.

Non-bank

'International investors are increasingly under pressure to be able to show ESG ratings for their investments. Australia really needs to take the stance at governmental level that energy certification has to be a part of any new property transaction and then there has to be a public register.

Global investor

Finding a niche

'I think for us, it's really about the problem that we're solving and I think for each non-bank, there's a different issue that they are seeking to look after.

Non-bank

Any area that the banks are not going to aggressively pursue that has more complex underwriting are less likely to be sought after by the banks so this is where non-banks have a competitive edge.

Global investor

What is interesting is that every customer is quite, does turn out to be quite different and the niches are often not necessarily what you would typically think of as a segment niche, like a self-employed or an SMSF, or reverse mortgage or a non-resident, it often comes down to how you view credit, how your credit policy looks.

Non-bank

Banks didn't like brokers and non-banks did. Non-banks grew because of broking. There was no channel conflict. Non-banks loved brokers more than banks did.

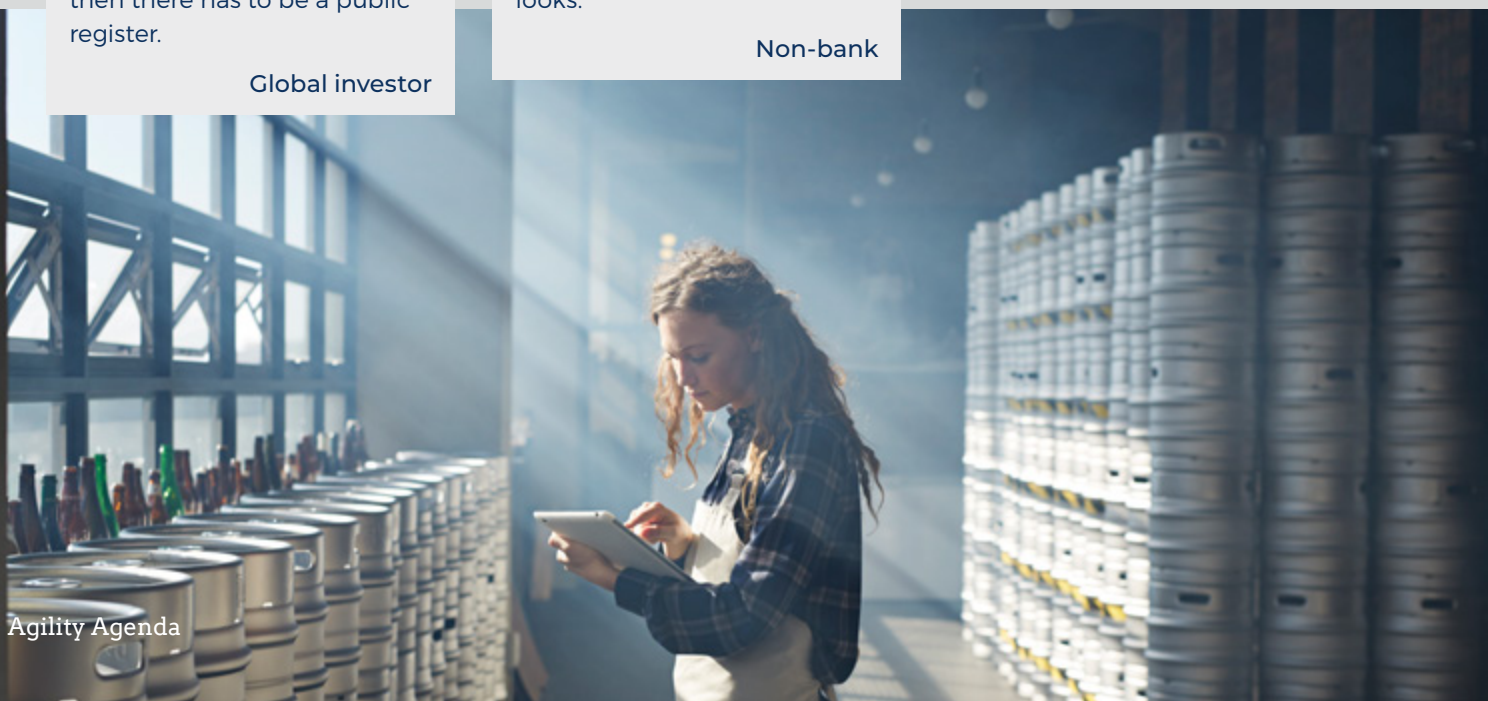
Non-bank

Non-banks have convinced the world you can do no doc or low doc.

Non-bank

Reason that non-banks do arrears better is if they get a deal that's not prime they provide more of a personalised service. We have a scenarios team where you talk about an individual customers' situation.

Non-bank



Market challenges

So I guess with rising rates, the bodies tend to float to the surface.

Warehouse

When you're issuing into the market in times of heightened stress or challenges, the price is the price and issuers are largely price takers not price makers.

Non-bank

What we've seen in the last four months is a massive re-rating of how expensive that equity capital is and so many of them have built business models based on equity capital being both cheap and in abundance and that is the rug that has been pulled from under them over a short space of time.

Warehouse

In mortgage bonds is probably, there's probably like actual true risk for the first time in a long time particularly if you've got a lot of high LTV loans with house prices going down so we're already sort of 10% down in Sydney and there's a lot of forecasts for sort of 20% prices down. So I guess if you're investing mainly in relatively lowly seasoned collateral in mortgages, then you're actually taking and you get sort of defaults in that sort of high LTV bucket and there's actual real chance of a loss. I think it's a low probability and I don't sort of see that as a base case, but we've definitely said no even more emphatically to sort of newer issuance term bonds and we sort of shy away from high LTV in our warehouses anyway.

Investor

New entrants

Established players know what we want to see from a credit perspective and it's a well-oiled machine versus the new ones that are still figuring out the ropes a little bit and you really saw that with the interest rate raises recently.

Investor

More established players knew they had to immediately reprice the book, because it was going to impact our cost of funding, etc.,. Whereas the early-stage players really held off on increasing rates because they were saying volume was still important rather than a focus on profitability. So there was that delay until they realised this was having a material effect on the funding side of the business.

Investor

Planning for growth

There's guys that value, the kind of long term relationship and the capital that we're bringing from the super fund industry. They're not necessarily trying to squeeze pricing down to the absolute tightest levels they can which they sort of do on term deals. It's more of a partnership and some of the issuers are happy to do fully drawn down mezzanine notes, which makes our life a lot easier as investors, or at least pretty healthy undrawn margins if we commit to facility limits, and I guess there's value in that sort of mezzanine capital that we bring to the space.

Investor

I think a lot of the structures onshore have been battle tested as well over time and they're very conservative in a way that we write risk onshore. I think if you're playing some of those offshore markets it's a bit of a different story, you've got to really know what you're looking for and what you're getting yourself into.

Investor

A lot of the people in this market or a lot of the issuers more generally, in this market, have been looking to stable funding partners rather than funding partners. So you're getting this real bifurcation between different types of funding that's been coming down the line. So the issuer as well is starting to get very selective, which is exactly what they should be doing.

Investor



Sector health

We have more opportunities than we have capital even after weeding out the ones that aren't suitable for us.

Warehouse

But look, the market goes through cycles. We've been here before. And we'll be here again. So we need to get through this period of central bank interest rate increases. And once the market has certainty as to where that is, then the market will start to recover. And then it is simply supply and demand.

Non-bank

We're definitely seeing a lot more people approach us for the warehouse funding and the number of warehouses and the size of warehouses definitely going up. So it's becoming much more important and I think if we had more capital, we could definitely deploy in a lot more warehouses. There's a bit of a lack of sort of mezz capital to go around the market at the moment. There's quite a lot of banks that are still active, but I'm happy to provide senior.

Investor

'I think what's really interesting about structured credit is you have five or six different tranches, which all move at different rates. So at any point in the cycle, each one of them could be displaying a different relative value.

Investor



About Perpetual Corporate Trust

Perpetual Corporate Trust's (PCT) vision is to be the leading fiduciary and digital solutions provider to the banking and financial services industry. Renowned domestic and global financial institutions leverage our unique suite of products across debt markets, managed funds, and digital solutions to support their business strategy, while acting in the best interests of all parties.

Perpetual Digital, PCT's innovation company, is a professional services business delivering SaaS products and data services. Our mission is to drive the success of our own PCT business as well as our clients by delivering next generation software and data solutions.

Our strategy is simple: enable client success by focusing on helping clients, and the broader eco system, be more effective, efficient, scalable and economical, while managing ever-increasing cyber security risks and maintaining compliance.

PCT has four business divisions with a broad range of products and services:

- **Debt Market Services** includes trustee, document custodian, agency, trust management, accounting, standby servicing and reporting solutions.
- **Perpetual Digital** provides data services, industry roundtables, software-as-a-service products as well as fixed income dealing and advisory through Laminar Capital.
- **Managed Fund Services** including responsible entity, wholesale trustee, custodian, investment management and accounting services.
- **Our Singapore business** provides both debt markets and managed fund products, specialising in Singapore Real Estate Investment Trusts "S-REITS" and cross border capital flows into Australia.

About Australian Securitisation Forum

The Australian Securitisation Forum (ASF) is the peak body representing the securitisation industry in Australia and New Zealand. The ASF's role is to promote the development of securitisation in Australia and New Zealand by facilitating the formation of industry positions on policy and market matters, representing the industry to local and global policymakers and regulators and advancing the professional standards of the industry through education and market outreach opportunities.

The ASF is comprised of a National Committee, specific subcommittees and a national membership of over 170 organisations.



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