Bad News: Your Bank Wants YOU to Carry All the Risk

Description

There used to be a saying that bankers followed the 3-6-3 plan: pay depositors 3% on their money, loan it out to credit-worthy companies at 6%, and leave the office at 3 p.m. to go play golf—a nice gig, in other words.

Well, an even nicer gig for bankers is the residential mortgage, where they enjoy the uniquely Canadian benefit of zero risk. The federal government and, by extension, the CMHC, have coddled them to such an extent that they honestly believe a risk-sharing proposal coming from the federal government is an unnecessary waste of time and resources.

“This is a solution in search of a problem,” **First National Financial Corp.** (TSX:FN) CEO Stephen Smith recently told Bloomberg TV Canada.

Oh, really?

As companies go, I don’t have problem with First National. In fact, I recently recommended that investors consider taking a position in its stock given the 20% haircut it took October 3 after the federal government announced four new changes to the housing rules in this country.

However, Smith’s assertion that there isn’t a problem here is simply untrue; it’s a flippant sound bite that’s not going to change my opinion. Here’s why.

Let’s say I come to you and ask to borrow $10,000 to finance my new business. You’d want to set the terms of that loan with an interest rate and duration appropriate for the amount of risk you would be making by lending me the cash.

If I’m trying to start up the next great stock app, you’d probably be worried that I wouldn’t generate enough revenue to pay you back. As a result, you’d set the interest rate much higher than the prime lending rate banks provide their best customers. You might even ask for collateral on that loan. At no time would you entertain the idea of lending me the money interest free unless you were feeling philanthropic.

But if you flip the entire mortgage lending process on its head, that's exactly what's happening with the banks. In essence, if Mr. Banker has zero-risk lending on residential mortgages that are insured, it's essentially the same thing as Mr. Banker getting an interest-free loan.

You wouldn't allow that to happen to yourself personally, yet we as Canadians are collectively giving banks and other mortgage lenders *carte blanche* with taxpayer money. The federal government is simply saying that the free lunch has got to stop.

The banking industry argues that it already undergoes a thorough underwriting process demonstrated by a delinquency rate of 0.28% for mortgages in arrears of 90 days or more.

"We don't understand what a deductible is intended to achieve as a policy outcome," said Darren Hannah, vice president of finance, risk, and prudential policy at the Canadian Bankers Association. "If it's supposed to be something to improve the quality of underwriting, well the quality of underwriting is already very strong."

He's not wrong.

But that doesn't mean our system shouldn't be changed to reflect what's happening in other developed countries. Canada isn't so special that we should be the only country in the world that backstops 100% of home mortgage insurance. This is taxpayer money on the line. Are the banks going to chip in if the proverbial you-know-what hits the fan in a U.S.-style housing collapse? Not on your life.

They [banks] argue that these new measures will result in higher mortgage costs. Is that so bad? Owning a home is a privilege, not a right. The combination of an ongoing stress test on both "high ratio" and "low ratio" mortgages with a deductible banks would pay on bad loans will help ensure that only those qualified to carry mortgages in most interest-rate environments do so while simultaneously lowering the risk to the Canadian taxpayer.

Let's not make bankers' lives any easier than they already are. It's time they carry some of the risk.

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1. Investing

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1. Editor's Choice

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1. TSX:FN (First National Financial Corporation)

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