Securitisation: A Government perspective

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Speech to ASF Annual Conference

Sydney

22 November 2011

I would like to start my remarks by thanking the ASF and Chris Dalton [CEO, ASF] for inviting me here this afternoon to speak at this 10th annual Australian Securitisation Forum Conference.

I am sure that all of you would have found the last two days very useful in reviewing developments in the industry, stimulating ideas and identifying opportunities for the Australian securitisation market.

The Government's objectives

I would like to spend some time this afternoon providing you with some background on the Government's policy in this area. I hope that it will provide some insight as to why the securitisation industry has received Government support over the last few years, and why we consider this industry is important to our financial system.

One key lesson from the crisis was the clear benefit from having diversified funding sources, both for an individual lender and the industry as a whole.

Having lenders able to call on a range of funding options, whether that be deposits, securitisation, covered bonds or long term unsecured notes, gives confidence they will continue to be able to provide credit to Australian households and businesses, even during times of financial uncertainty.

The Government places a high level of importance on the provision of credit - it is the life-blood of any modern economy.

It provides Australians with the freedom to make choices about what they want to consume, and when.

The Government's policy is to ensure credit is available on reasonable terms, providing Australians with the ability to make their own decisions about consumption and investment.

The Government wants aspiring homeowners to be able to approach a lender, whether it be a bank, mutual or non-ADI, and buy a home with credit on reasonable terms.

The Government wants entrepreneurs to be able to call up their business lender and access the capital they need to start or expand their business.

Of course, competition is fundamental to this policy objective.

The Government wants an innovative and flexible retail market where customers get value for money, as well as the opportunity to shop around to get the best possible deal for their circumstances.

As you would know, the Deputy Prime Minister has already taken a number of steps to give customers more control over where they do their banking business.

Around this time last year the Government announced a range of policy commitments as part of the Competitive and Sustainable Banking System reforms package. The banning of exit fees on new home loans, the introduction of a home loan key facts sheet and measures to improve bank account portability all seek to empower borrowers to get a better deal from lenders.

The package also emphasised the importance that smaller lenders play in creating and maintaining competition. The package includes several measures to assist smaller lenders, such as introducing a new official 'Government

Protected Deposits' seal and confirming the financial claims scheme as a permanent feature of our financial system.

The Government has supported the market

As part of the package, the Government announced a number of measures to secure the long term safety and sustainability of our financial system. These included allowing the removal of restrictions on the issuance of covered bonds by ADIs, actions to encourage the development of the corporate bond market, as well as the extension of AOFM's investment in the securitisation market to a total of $20 billion.

I have seen the recent inaugural issuances of covered bonds by some of our majors into offshore markets. Covered bonds will play an important role over the longer term in funding our financial system as a whole, but they are only one part of a bigger picture.

While the major banks have been the first to issue covered bonds, at the same time as its decision on covered bonds, the Government announced the Australian Office of Financial Management's securitisation program, directly targeted at smaller institutions, including the non-bank lenders.

The AOFM program helps those smaller lenders, particularly those who were reliant on securitisation pre-GFC, to be able to continue to provide retail credit in direct competition with the bigger banks.

I think we often run the risk of glossing over the magnitude of the Government's commitment to the securitisation industry. $20 billion is a big program for Government, and shouldn't be underestimated. As a comparison, the Government's equity investment in the NBN is only about $27 billion in total.

The Government's decision to invest such a large amount directly into the market clearly provided support for the industry during a very difficult period. The AOFM was a willing buyer at a time where most other investors were pulling out of the market.

Given the size of the Government's support for the securitisation industry, I am very happy the program has proved successful in mitigating the very significant adverse impacts of the GFC.

It assisted not only smaller lenders to continue to provide Australians with finance, but importantly it has also assisted the securitisation industry maintain vital market infrastructure, allowing it to more quickly rebound once private demand did return to the market.

The AOFM program has so far assisted around 20 different smaller lenders to raise around $35.9 billion to lend in the retail market, leveraging off the more than $14 billion or so directly invested by the AOFM.

In terms of retail assistance, this means that approximately 195,000 households have been directly assisted through the AOFM program so far. In addition, a significant amount of funds have also been allocated by issuers to be lent to small businesses.

From my perspective, not only has the program assisted smaller lenders during a difficult period, it has also been successful in minimising the risks for Government.

- Investing only in AAA rated tranches has meant that taxpayers are only exposed to minimal credit risk.

- The active involvement of AOFM has meant that the Government's investments have been made by highly qualified staff under strict controls. As many recipients can attest, the Government commitment is appropriately managed. AOFM is adept at minimising the risk to the Government's balance sheet.

Encouragingly, the AOFM program has also indirectly helped other issuers return to the market. The big four banks have issued significant volumes of securitisation over the last few months, while a number of commercial and sub-prime issuers have re-entered the market.

Will the securitisation market reach a new equilibrium

Securitisation issuance in the first half of 2011 has been the strongest since 2007, with the re-entry of the major banks accounting for a large proportion of this growth. The return of more significant private demand and a tightening of spreads in the secondary market supported primary transactions and reduced the extent that AOFM support was required during the first half of the year.

While there has been some issuance of commercial mortgage backed securities this year, it remains very low compared to pre-crisis levels.

Although the European debt crisis has dampened investor confidence and led to a slowdown in RMBS issuance in the second half of the year, the Australian market remains open, with a number of deals successfully completed in the last two months.

I am hopeful that this trend will continue in the future and the securitisation market remains a viable funding source for a wide range of our lenders.

Despite the AOFM program, three years down the track, the industry has accepted the fact that it is unlikely we will see the market return to pre-GFC prices or volumes, at least in the foreseeable future.

The absence of demand from offshore Structured Investment Vehicles (SIVs), whose business models were challenged by the crisis, and a general repricing of risk precludes a return to the days when very low basis point spreads were achievable.

The Australian market continues to function, albeit at slightly higher pricing, despite many funding markets in offshore markets being effectively closed due to the European sovereign crisis. Not only does the RMBS market continue to show signs of resilience, but both the ABS and CMBS markets seem to showing signs of life as well.

This is of course partly because of the very high quality product that is being sold. Australian mortgages continue to record very low delinquencies, underpinned by the strong Australian macro economy.

In the longer term, I am confident the securitisation market will remain an important part of our financial landscape.

But as the most recent direction from the Treasurer to the AOFM stated, the program has an objective of "*encourage a transition towards a sustainable and innovative securitisation market that is not reliant on Government support*".

One of the Government's messages is that the future of the industry is in your hands. The Government is assisting you through a difficult period, but in the longer term, it is up to the people at this conference to show the initiative and take the securitisation market forward.

That being said, we are all keeping a close eye on developments in Europe, and are hopeful that political leaders will take the steps necessary to provide confidence to financial markets.

But regardless of what happens offshore, I think we have proven that here in Australia, the Government is willing to make the difficult decisions, and step into the market when it is required to protect the national interest.

Other Issues

I now have a couple of comments to make on some issues that have been discussed over the last few days.

The first concerns developments in the regulatory framework that applies to issuers and holders of RMBS, especially ADIs. I hope that recent announcements have gone some way to clarifying the Australian regulatory framework.

I understand that APRA has already talked at this conference about their position on the prudential requirements for securitisation going forward. I hope that the clarification that ADIs can continue to use hold b-notes on their books, with the appropriate capital of course, will put some minds at ease.

Given the lack of private demand for b-notes, and the Government's position that they are not willing to take on this sort of risk, I think this is a positive outcome for the market. I am of course hopeful that with the passage of time, the attractiveness of the b-note tranches of securitisations will lead to investors returning to this market, and issuers having the option to sell these notes at a better price.

In addition, APRA's and RBA's announcement with respect to the pricing and framework of the new liquidity facility should also bring some certainty to the market. I have already heard some comments from people in the industry on the impact of this announcement for the securitisation market in particular, but I would be interested in hearing your views at the panel discussion that will follow this speech.

I should also briefly mention the issue of disclosure for securitisation. I understand Greg Medcraft mentioned yesterday that ASIC and Treasury were considering the potential for additional regulation to ensure that disclosure of RMBS products is consistent and of a high quality.

With the ASF already taking steps to standardise disclosure, the question is whether these industry agreed standards should have some regulatory backing. If industry considers that mandating a particular wholesale disclosure standard is in the interests of the market, we are open to this option.

I have also recently heard stakeholders discussing the role of superannuation in the securitisation market, particularly as a significant source of demand.

As you would be aware, the growth of superannuation in Australia has led to large amounts of money in superannuation accounts looking for viable investments.

Of course, trustees are investors just like any other buyer. They operate within set mandates and seek to maximise the return on their investments at a minimum of risk.

If you can match the risk and return characteristics demanded by superannuation funds, and convince them of it, I am confident you would be able to attract super funds to invest in products you can offer.

In conclusion, the Government wants the finance industry to be able to call on a range of funding options, so that even in times of financial uncertainly, credit can still flow to Australian households and businesses

We want our banks, credit unions, building societies and non-ADIs to be competing with each other to provide high quality, tailored credit products that match customers' needs.

Securitisation plays an important role in ensuring these objectives are achieved.

I hope you have found these comments, and this ASF conference more generally, useful in your ongoing work in the securitisation industry.

Thank you.