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Loan, Nick

From: Douglas, Justin
Sent: Thursday, 9 September 2010 5:57 PM
To: Murphy, Jim
Cc: Lonsdale, John; Loan, Nick; Cook, Katherine
Subject: Securitisation 1 pager [GEG=PROTECTED]
Attachments: 100909 Securitisation 1 pager for Jim.docx

Security Classification:

~~PROTECTED~~

Jim,

Please see attached a one-pager on the securitisation work, what it is, when it could be done and next steps.

Justin

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Securitisation - options for a viable market and next steps

Securitisation is important for both the financial sector funding issue and competition.

- Before the GFC, ADIs were issuing around \$50b pa of RMBS, with more than half being purchased by offshore investors.
- While most RMBS issuance was by major banks, the second tiers and non-bank lenders were much more heavily reliant on RMBS to raise non-deposit funding.

Prior to the GFC, one-third of RMBS investors were structured investment vehicles (SIVs), which have largely disappeared. The remaining investors, both domestically and offshore, remain wary of purchasing traditional RMBS. This is exacerbated by overseas regulatory changes, especially Europe.

Treasury and ASIC are examining options for encouraging the development of an RMBS market by attracting new groups of investors. APRA and RBA have participated in meetings and have also made lesser, but constructive, contributions.

The key idea is to encourage RMBS to be issued as bullet (single fixed maturity) instruments rather than traditional RMBS, which amortise depending on when borrowers repay the underlying loans. This means that the payment profile for the investor is the same as a bond and that the bullet RMBS would be eligible for inclusion in international bond indices. Inclusion in the indices would guarantee investor demand from fund managers that hold an index portfolio, as well as encouraging other investors.

Other features of the option we are examining are using a master trust and/or pooling arrangements to facilitate use by smaller lenders and promote competition. These will require prudential factors to be taken into account in designing the market, but in APRA's view shouldn't be insurmountable.

It could take until the end of 2011 to get a bullet securitisation market operational, although there may be options to accelerate this. One is to transfer some of the RMBS currently held by the AOFM into a master trust to seed it so that it can issue a first tranche of bullet securities and provide a price signal before banks and other lenders start to access it. This would have the benefit of potentially selling down part of the AOFM's RMBS holdings at the same time as facilitating the emergence of a new market (so long as we don't try to sell all of the AOFM's RMBS holdings too quickly).

The bullet nature of the securities means that there is a rollover risk as they mature and the master trust takes the underlying RMBS back onto its books. To ensure that this isn't a problem, the master trust could be prudentially regulated (we are still considering if its capital should come from government or the banks). The AOFM could also provide a liquidity facility, which could be limited to buying back the RMBS that it sells into the trust if they cannot be rolled over into new bullet securities. Since this involves buying back RMBS that we currently own, the net risk to the Commonwealth is negligible and could attract a small amount of fee revenue. Independent of this work between ASIC and Treasury.

Section 45, Branch of confidence

The next step with this proposal will be to get agreement of the SMWG and CFR to support the development of a detailed option that meets the needs of all of the regulators. To date they have all been constructive, but need to be locked-in to the process as it moves into more detail. The Treasurer's agreement to continue to develop this option will also be needed so that we can talk to current market participants (rather than ex-participants now working in ASIC). I am hopeful that we could then develop a more detailed proposal either for the Treasurer's consideration in late October or further consideration by CFR in November. This would coincide with the likely timing of when we would need a decision about the future of the AOFM RMBS investment program.