2

TREASURY EXECUTIVE MINUTE

Minute No. 10/2212

10 September 2010

Deputy Prime Minister and Treasurer

BANK FUNDING

Timing: A meeting with Treasury is scheduled on these issues for 1:30pm, 15 September 2010.

Sub-paragraph 22(1)(a)(ii)
(not relevant to request)

- The second tiers and non-bank lenders are very reliant on securitisation. While the AOFM residential mortgage-backed securities (RMBS) program has supported competition, these smaller lenders are becoming increasingly reliant on this support. Further, the $16 billion AOFM program is likely to finish around the end of 2010.

Sub-paragraph 22(1)(a)(ii)
(not relevant to request)

Sub-Paragraph 22(1)(a)(ii)
(not relevant to request)

- Diversification of funding sources, through widening the banks' investor bases, providing more funding tools and decreasing larger businesses' reliance on the banks would assist the stability of banks' funding sources.
- Some possible options to diversify banks' funding sources include:
  - a new model for securitisation using 'bullet bonds' (that is, bonds where the issuer guarantees to repay the entire principal on maturity, rather than as the underlying mortgages are repaid). Government support for this, if warranted, could range from AOFM support of private models set up by industry under its current mandate through to the Government piloting such a model;

Sub-Paragraph 22(1)(a)(ii)
(not relevant to request)

<u>Next steps</u>

- The main short-term pressure will be to decide if further actions should be taken following the completion of the AOFM RMBS program. While another tranche of support may be warranted, it would be desirable to transition at the same time to a more sustainable funding arrangement for the second tier banks.
  - We will engage members of Treasury's new Financial Services Advisory Panel to assist assessing the impact and merit of a new securitisation model using 'bullet bonds' and provide further advice on securitisation options in October.
- Once the work being undertaken through the CFR and the ABA over the coming months has progressed, we will provide further advice on the other options discussed above.
- The following areas have been consulted in the preparation of this minute: Budget Policy Division, Macroeconomic Policy Division, Corporations and Financial Services Division

John Lonsdale
General Manager
Financial System Division

Contact Officer: Justin Douglas Ext: 2401

ADDITIONAL INFORMATION

Sub-Paragraph 22 (1) (a) (ii)
(not relevant to request)

Possible options to assist funding of Australia's banking system

A new model for securitisation

- While the AOFM RMBS program has supported competition by allowing second tiers and non-bank lenders to continue to raise funds, pricing and volumes are still not at a level where securitisation is a competively-priced source of funding for these lenders.
- Together with ASIC, we are examining options for reviving the RMBS market by attracting new groups of investors.
  - The key idea is to encourage the private sector to issue RMBS as 'bullet bonds', that is, bonds where the issuer guarantees to repay the entire principal on maturity, rather than as the underlying mortgages are repaid.
  - This would mean that the bullet RMBS would be eligible for inclusion in international bond indices. Inclusion in bond indices would guarantee investor demand from investor groups that are required to match the bonds in the index when investing their portfolios.
    - : The potential investor base for bullet RMBS could be substantial. ASIC have estimated that there is potential for up to $20 billion per annum of new investment in RMBS from these investor groups.
  - It may also encourage other investors who are familiar with the payment profiles of bonds.

sub-paragraph 22(1)(a)(ii)
(not relevant to request)

Sub-Paragraph 22(1)(a)(ii)
(not relevant to request)