Australian Securitisation Forum

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Financial regulatory framework and home ownership inquiry – Australian Securitisation Forum Submission

On behalf of the Australian Securitisation Forum (ASF) and its members, we are writing to address several of the terms of reference of the Senate Standing Committee on Economics inquiry into the Australian financial regulatory framework and home ownership (inquiry) and provide an overview of the Australian securitisation market.

This submission primarily comments on the first point of the inquiry relating to prudential standards adopted by the Australian Prudential Regulation Authority (APRA) and the case for a liquidity back stop facility for the securitisation market to be implemented using a similar legislative framework to the Structured Finance Support Fund (SFSF).

1. Australian Securitisation Forum

The ASF is the peak industry association representing the securitisation and covered bond sectors in Australia and New Zealand. The ASF's role is to promote the development of securitisation and covered bonds in Australia and in 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 200 institutions and market organisations. Further information on the ASF and its activities can be found at www.securitisation.com.au

2. Overview of the Australian securitisation market

Brief overview

Securitisation is an important part of Australia's financial system and is a flexible funding tool for regulated bank, non-bank and new emerging lenders seeking to fund their business through the debt capital markets. Securitisation benefits homeowners, consumers and small business through increased competition and product innovation and serves parts of the market that regulated banks find less attractive.

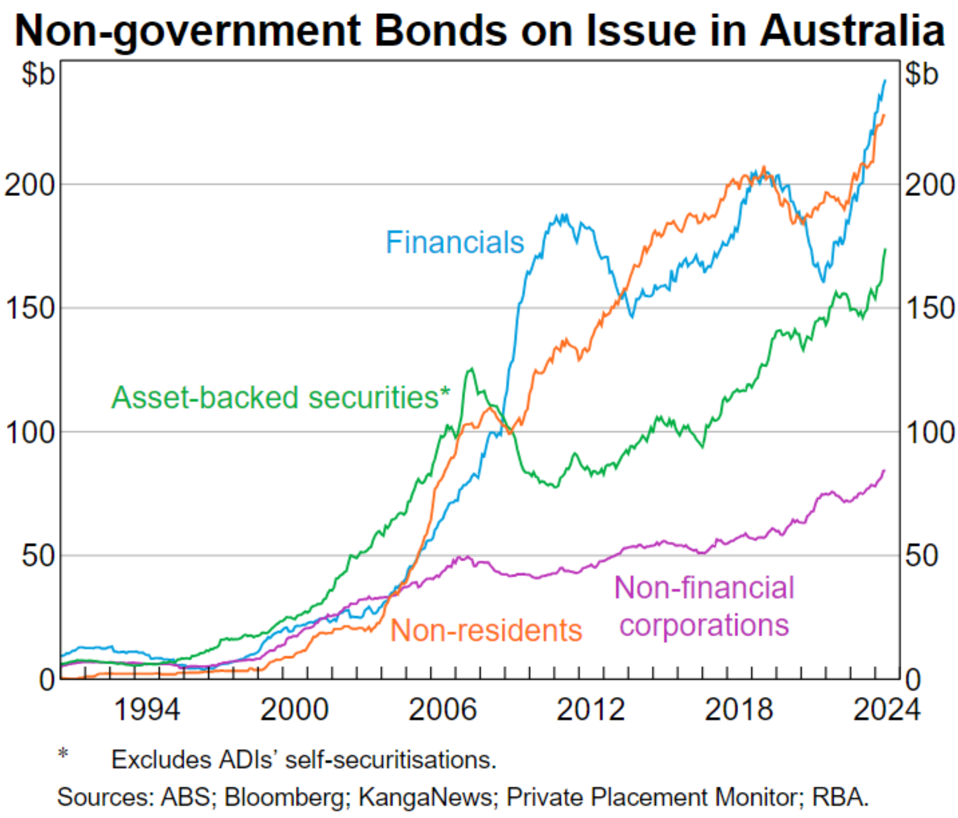
Securitisation is a form of secured funding backed by a pool of financial receivables. The process involves the creation of a bankruptcy remote special purpose vehicle which issues debt securities to purchase a pool of financial assets. The investors in those securities are insulated from the corporate insolvency risk of the lender or originator of the assets and are dependent on the cash flows of the assets for the repayment of principal and interest. This insulation allows the credit of the portfolio to be rated by credit rating agencies more highly than the credit of the lender or originator, which in turn allows borrowing to be made available at lower rates. Such cost savings frequently reduce the costs ultimately faced by borrowers.

Size of the Australian securitisation market

According to the latest release from the Australian Bureau of Statistics, as at 30 June 2024, total assets outstanding for Australian securitisers were A$193.3 billion (an 8.4% increase from the previous quarter). For the first half of 2024, total public securitisation market issuance volumes were approximately A$43.8 billion across a record 56 subsisting transactions. The massive volume placed in 2024 alone is almost double the volume completed at the same time in 2023 and was the busiest first half in the Australian securitisation market since 2007.

As of December 2023, there were more than A$2.247 trillion of home loans outstanding in Australia of which around 6.2% were securitised.

According to the Reserve Bank of Australia (RBA), asset backed securities represent a significant proportion of non-government securities outstanding in the Australian bond market.



This demonstrates that securitisation represents an important part of the funding requirements of Australian financiers and lenders and for the non-bank sector in Australia is the primary source of funding. Annexure 1 to this letter sets out further key Australian securitisation market statistics, including data from Standard & Poor's, which reflects a highly performing residential mortgage-backed securities (RMBS) market with moderate arrears.

In addition to the traditional forms of RMBS securitisation, the securitisation market has diversified in terms of innovation and product offering to consumers with the asset backed securities market having grown significantly in the last three years to include personal loans, credit cards, autos, equipment and other SME lending activities. Non-resident and non-conforming mortgage lending (which largely includes loans to the self-employed) continue to be dominated by the non-bank sector and consequently form part of the RMBS securitisation market.

ASF perspective

The Australian securitisation market serves a vital role in facilitating the supply of finance for homeowners, consumers and SME businesses. The Australian securitisation market is a growing and diversified public (non-government) market. It provides a competitive dynamic in Australia's concentrated banking market to exert downward pressure on margins for mortgages and other consumer and SME finance than otherwise would prevail in the absence of the public securitisation market.

3. Australian regulation of securitisation

Regulation

Australian market participants (banks, non-banks, intermediaries and investors) are regulated by the Australian financial services licensing body and conduct regulator, the Australian Securities and Investments Commission (ASIC) and are required to report their securitisation activities to the Australian prudential regulator, APRA and/or to the central bank, the RBA. As a proportionately well-regulated market, there are well developed and pragmatic protections in place for both issuers and investors.

Australia has a well-developed prudential framework in place for securitisations. However, unlike Europe and the US, it has never considered it necessary to introduce non-prudential regulation of securitisations (such as risk retention or prescriptive investor due diligence requirements) but rather has taken a measured approached to regulatory intervention.

Other than specific prudential regulation such as Australian Prudential Standard 120 – securitisation (APS120) and APS112/APS113 – risk weights) applicable to authorised deposit taking institutions (ADIs), the Australian domestic securitisation market has managed to self-regulate on both the buy and sell sides. The departure from a prescriptive European style securitisation regulation (governing all attributes of securitisation issuance and investment) has not resulted in systemic risks appearing in the Australian securitisation market. In fact, investment in Australian securitisations continues to grow with newer entrants accessing the market and more diverse assets being securitised. The investor base for Australian securitisations has also expanded significantly beyond the domestic market to include the UK, Europe and Asia, particularly Japan. This is a testament to the strength of the practices employed by Australian issuers managing securitisation portfolios and the structural protections incorporated into Australian securitisation transactions.

There are market driven data reporting guidelines developed by the market to encourage a consistent approach to reporting with respect to commercial transactions. Although this is not strictly an investor requirement, its aim has been to provide a standard of reporting to which local and offshore investors are receptive. An example is the ASF's data reporting template for SME receivables which can be found on the ASF's website:
https://www.securitisation.com.au/market_guidelines/sme-reporting-template

Separately, the RBA conducts regular open market liquidity operations to provide liquidity to financial institutions by entering into repo transactions with respect to its asset backed securities which are subject to certain eligibility criteria. A key eligibility criterion is the loan level reporting requirements (for which the RBA has prescribed a template). Again, this is not a strict investor requirement but a guideline which only applies if a sponsor/originator is keen to ensure liquidity with the RBA.

Australian prudential treatment of securitisation

Prudential regulation has a primary focus on financial stability and depositor protection. Recent reforms of prudential regulation affecting the lending for home ownership reflect the Government's direction to APRA to implement a policy to achieve "an unquestionably strong" profile for all regulated ADIs in Australia.

Although the prudential framework for securitisation (i.e. APS120 and APS112/APS113) is specifically applicable to ADIs in their capacity as bank issuers, it is also relevant to non-bank lenders who rely on bank warehouse facilities as a fundamental stage in their originations funding cycle. The costs of the bank providing warehouse facilities (by investing at the most senior investment tier) to fund non-bank originated assets is passed onto the non-bank and ultimately paid for by the borrower. However, it is a concern that risk weighting for specific loans such as residential construction loans is too severe and is having an impact on the availability and cost of these loans to the borrower. Construction loans attract risk weighting of 150% which means that originators must maintain at least 12% credit enhancement in the warehouse compared with only 8% for standard mortgage loans. Obviously, this means that originators pay to their bank warehouse providers a significantly higher margin for construction loans resulting in costly financing for a borrower to obtain a residential construction loan.

ASF perspective

The current prudential framework does not give direct priority to the level of home ownership. Should the Government wish to give greater balance in prudential regulatory settings to prioritise home ownership or competition in home loan lending it could reconsider if the regulatory risk weights for certain loans such as first home loans or residential construction loans are appropriate and reflect the financial strength of the borrowing cohort.

4. Government intervention in the securitisation market

Earlier intervention

In the 1980s a number of state governments established funding programs to provide home loans to borrowers that did not meet the lending criteria of the main banks. Examples of these programs included the Fanmac mortgage-backed bond program established by the New South Wales State Government and the National Mortgage Market Corporation mortgage-backed bonds established by the Victorian Government. These residential mortgage-backed securities were issued with a guarantee of the respective state governments (at the time rated 'AAA'). The programs enjoyed some success in terms of market acceptance but started to come under pressure when the recession of the early 1990s increased borrower defaults and property price declines were witnessed in a number of regions in Australia. Ultimately the cost to the state governments of increasing defaults, interest rate mismatches and property price declines eventuated in a wind up of the various programs at a cost to taxpayers.

ASF perspective

Historical long-term interventions in the home loan market to influence the affordability of housing and availability of finance have not had stellar outcomes for taxpayers who bore the cost of both the NSW and Victorian schemes.

Temporary government Intervention for market disruptions

The Federal Government, through the Australian Office of Financial Management (AOFM), first interceded in the public RMBS market at the time of the global financial crisis in 2008 to provide liquidity to a market that had been disrupted at a global level. The scheme was an enormous success, with all government investments eventually refinanced and rather than creating any losses, yielded a profit to the Australian taxpayer.

This successful form of government support led to the design and implementation of the Structured Finance Support Fund (SFSF) during the COVID period commencing in 2020, again to ensure that in an adverse domestic and global bond market with limited liquidity brought about by a global pandemic, non-bank originating lenders would still be able to raise funds from the public bond market and continue to provide home loans to Australian borrowers.

The SFSF allocated public funds for qualifying investments in both public securities and private warehousing. The SFSF complimented the RBA's Term Funding Facility (TFF) by providing liquidity to qualifying ADIs. The corollary of these forms of sponsored intervention was that as soon as the private bond markets were fully functional, the investments would have to be refinanced over a period of time. This arrangement was to ensure that the SFSF (and even the TFF) would be made whole and despite the advantageous pricing of the schemes, there would be little risk of any losses to the Australian taxpayer.

The Government was able to implement the SFSF in a relatively short timeframe because there was broad political support for a standalone sponsored support fund that would provide investments in securitisation transactions rather than guaranteeing the entire transaction. Legislation was introduced and passed in record time and the infrastructure for administering the

SFSF was already in existence with the Government's debt financing arm, the AOFM, again fulfilling the role. This approach set Australia apart from other global jurisdictions by creating a level of confidence that saw real money investors continuing to support Australian securitisations throughout the pandemic.

ASF perspective

Given the success of the SFSF, it would be beneficial for a SFSF style liquidity back stop facility to be put in place which could be easily activated under the direction of the Treasurer or Minister of Finance in the event of disruption in the banking and capital markets or where other market distortions are significant.

This would help ensure that non-banks and small banks, who rely on securitisation to fund their loans, would still be able to originate and write new loans and of course compete where necessary with financiers such as ADIs who are less reliant on securitisation.

The ASF would welcome the opportunity to appear before the Senate Committee to elaborate on matters outlined in this submission and indeed any other matter relating to the funding of the home loan market through securitisation.

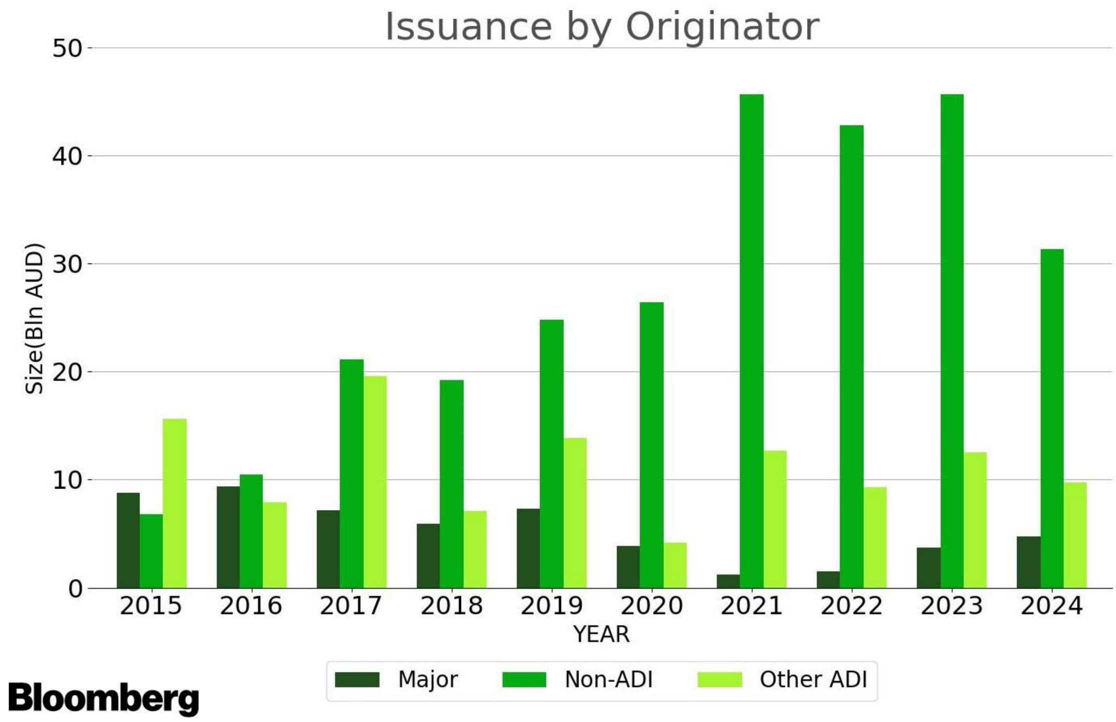
In the meantime, if you have any queries please do not hesitate to contact either Chris Dalton, Chief Executive Officer at cdalton@securitisation.com.au or Robert Gallimore, Policy Director at rgallimore@securitisation.com.au

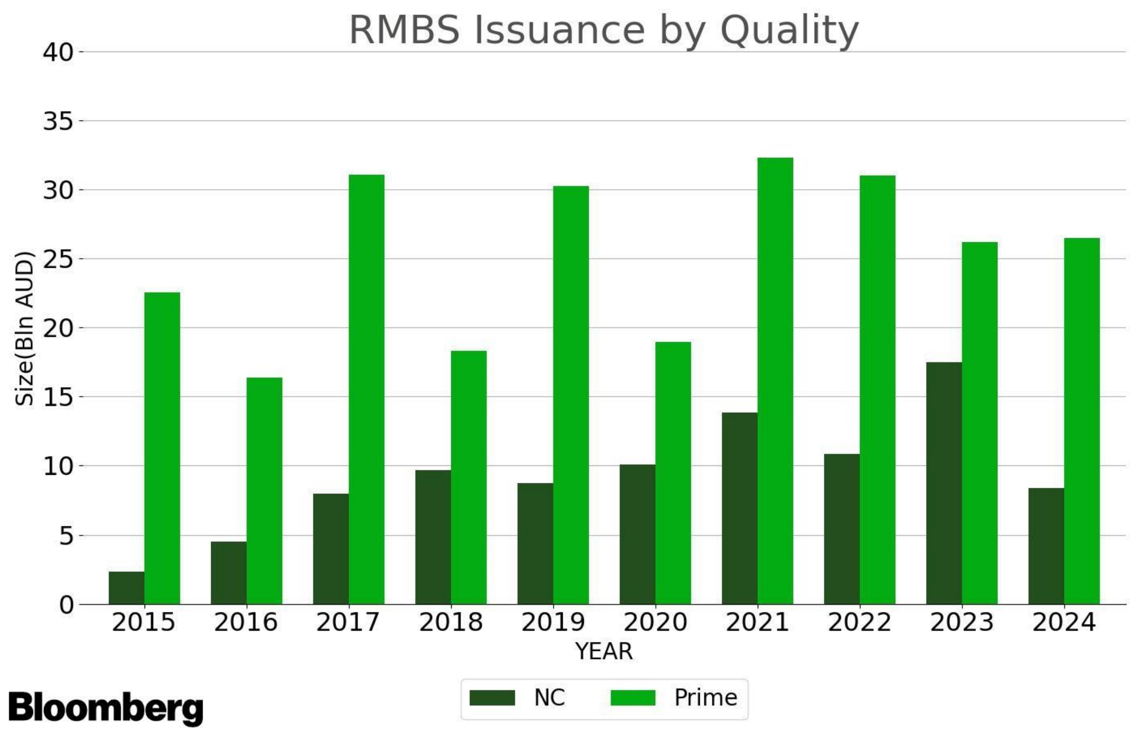
Yours sincerely,

Chris Dalton

Chris Dalton, Chief Executive Officer – Australian Securitisation Forum

Annexure 1 – Statistical overview of the Australian securitisation market





Standard & Poor's RMBS Performance Watch Australia – Prime RMBS Arrears (Excluding non-capital market issues) – 30 June 2024