

CONFIDENTIAL

11 March 2009

The Hon. Wayne Swan MP Treasurer Parliament House CANBERRA ACT 2600

Dear Treasurer

Re: Relief measures to promote commercial lending and the operation of mortgage funds

Further to my recent discussions with your officers concerning the Government's guarantee of the deposits and wholesale funding of Australian ADIs, we propose some interim and permanent relief options to improve the operation of the mortgage fund and commercial lending sectors.

As you are aware, mortgage funds are an important source of funding for the commercial lending sector, primarily commercial property, and have played a critical role in creating competition in this market. The sector lends approximately \$8 billion per annum to commercial property investors and has provided funding for many businesses which has usually not been available in the banking sector.

The current guarantee arrangements and economic volatility have contributed to a significant increase in redemptions and a cessation of new investment monies/applications flowing into the mortgage fund market.

As a result of these two factors mortgage funds are currently facing liquidity constraints which means they are unable to provide funding for new commercial loan arrangements, roll-over their maturing book of loans or to meet (in full) redemption calls from investors. Ultimately, these issues have adversely impacted competition in the commercial lending market.

To support the industry in recommencing and renegotiating commercial lending arrangements and to ease liquidity pressures to facilitate redemptions (and assist investors), we propose that the Government implement the following interim relief measures:

1. Interim relief to support commercial lending arrangements: Government to temporarily invest directly in eligible mortgage funds

We note that Government has previously acted to provide support to the Residential Mortgage-Backed Securities (RMBS) market and the car dealer financing industry to specifically foster competition in the respective residential and car lending markets.

We welcome the consideration of similar relief being extended to the mortgage fund industry and involve the Commonwealth Government (via, for example, the Australian Office of Financial Management, Reserve Bank of Australia or Special Purpose Vehicle) investing in eligible mortgage funds.

Email: <u>ifsa@ifsa.com.au</u> Fax: 61 2 9299 3198

Subject to the establishment of an appropriate eligibility criteria, we propose that the Government purchase units in eligible mortgage funds.

Under this proposal mortgage funds would apply directly to Government to invest in existing funds or new funds presented by an existing mortgage fund provider. Consistent with previous initiatives, the eligibility criteria should be fair, transparent and open to all mortgage funds to apply. We are prepared to work expeditiously with Government on developing these requirements.

This investment action would immediately provide a source of capital facilitating the refinancing of maturing commercial loans from existing mortgage funds and facilitate the funding of new commercial loan arrangements in either existing or new mortgage funds.

We note that there will continue to be circumstances where redemption requests exceed available liquidity and the legal requirements of a responsible entity in an existing fund would restrict the ability to facilitate new commercial loan arrangements via the new funding. For that reason we have also proposed that the investments in these circumstances may need to be made in eligible new funds (presented by an existing mortgage fund provider).

We are aware that you and your parliamentary colleagues would be receiving many inquiries from constituents regarding the liquidity of Australian mortgage funds. By investing in new mortgage funds, liquidity would also progressively be provided to an existing fund as maturing loans are refinanced by the new funds. Direct investment in existing mortgage funds would similarly provide a source of liquidity to support these funds in meeting redemption calls from investors.

In order to promote ongoing stability in the mortgage fund and commercial lending markets, the Government's investment should be on at least a medium term basis and reviewed in line with market conditions and the operation of the Government's guarantee. If this solution is of interest to you, we would welcome the opportunity to meet with you to further discuss the level of funding that is required to inject sufficient liquidity to assist this important part of the commercial property market (which currently does not have access to other government liquidity support arrangements such as ABIP or the government guarantee of wholesale funding for ADIs).

As markets stabilise and investors return to the mortgage fund sector we expect that the Government would seek to redeem its units. Appropriate redemption arrangements, however, would need to be agreed so as to avoid a recurrence of the type of liquidity problems currently being experienced. For example, a fixed term investment structure or securitisation model may be appropriate. For the same reason, we would expect that the new funds presented by an existing mortgage fund provider would have redemption arrangements for retail investors which would reflect the medium to long term nature of these investments.

Monthly distributions will be made to the Government in line with the returns on these funds.

2. Interim relief to instil confidence: Government announcement to further promote consumer & business stability

As you are aware, members' compliance with IFSA Standards and Guidance Notes ensures the promotion of industry best practice. In July 2008, IFSA released a new Standard No. 18 ('Best Practice Guidance for Disclosure in the Mortgage Trust Sector') promoting uniform disclosure and the efficient operation of mortgage funds. IFSA also liaised extensively with ASIC on developing the Standard and compliance is mandatory for IFSA members.

Additionally, ASIC released Regulatory Guide 45 ('Mortgage schemes - improving disclosure for retail investors') setting out compliance benchmarks for improved disclosure to retail investors to further assist them understand and assess these schemes.

Given the sound legislative framework underpinned by various Commonwealth statutes, ASIC guidance and IFSA's Standards, mortgage funds adhering to these regulations and principles are held in high regard and underpin a world class managed investments/superannuation system.

In order to support investor confidence in the mortgage fund market, it would be helpful if the Government made an announcement highlighting that mortgage funds are a well established investment vehicle that operate within a world class regulatory environment.

IFSA will also continue to assist advisers and investors to understand the mortgage fund(s) they invest in and encourage further engagement with the mortgage fund industry to assist it meet an investor's investment objectives.

Permanent policy position – narrow the existing guarantee

We strongly encourage the Government to consider our submission and policy options paper from January 2009 proposing a number of long-term recommendations to support the Australian banking and funds management sectors.

IFSA's recommendations are largely focussed on a gradual reduction of the \$1 million bank deposit guarantee threshold to \$50,000 over 18 months (and in line with market conditions) with that level being retained for a further 18 months before being closed (IFSA's submission has been attached).

Progressively lowering the threshold would improve current market distortions and reduce (but not eliminate) the incentive to transfer funds from mortgage funds to ADIs. This action will ultimately support ongoing investment in the mortgage fund industry, liquidity in the debt markets and competition in the commercial lending sector.

We would be pleased to further discuss these recommendations and industry arrangements to implement the proposed proposals, including establishment of an eligibility criteria. Should you require any further information, please do not hesitate to contact myself or Joseph Sorby on 02 9299 3022.

Yours sincerely

John O'Shaughnessy

Deputy Chief Executive Officer

Cc: The Hon. Lindsay Tanner MP

Minister for Finance and Deregulation

The Hon. Dr Craig Emerson MP

Minister for Small Business, Independent Contractors and the Service Economy; Minister Assisting the Finance Minister on Deregulation

The Hon. Chris Bowen MP

Assistant Treasurer and Minister for Competition Policy and Consumer Affairs

Senator the Hon. Nick Sherry Minister for Superannuation and Corporate Law

Dr Ken Henry AC Secretary, The Treasury