

Senate Standing Committee on Economics

ANSWERS TO QUESTIONS ON NOTICE

Treasury Portfolio

Supplementary Budget Estimates

21 – 22 October 2009

Question: sbt 4

**Topic: Residential Mortgage-Backed Securities (RMBS)
Purchase by AOFM**

Hansard Page: Written

Senator PAYNE asked:

1. The Department would be aware of the Treasurer's announcement of 26 September 2009 instructing the Australian Office of Financial Management to purchase \$8 billion worth of Residential Mortgage Backed Securities. Has that process been completed?
2. What was the overall level of interest in this process? Has the reaction been mostly positive?
3. Can Treasury inform the Committee whether the AOFM has finalised the last mandate of this process? It is understood the closing date was 18 September 2009.
4. How does investment by the Australian Office of Financial Management in RMBS achieve the goal of maintaining competition in residential lending?
5. The criteria for this process required \$4 billion to be allocated to non authorised deposit taking institutions. Can Treasury confirm this has been the case? Which non-authorised deposit taking institutions have participated in this process?
6. Each mandate or round of investment has been subject to specific criteria related to the contribution the RMBS will make towards maintaining competition in residential lending. What has been the overall extent of compliance with the criterion?
7. Mortgages forming the part of the RMBS investment were required to meet certain minimum requirements. Over time is it possible for mortgages within these pooled RMBS to be varied and no longer meet these minimum requirements?
8. What is the length of time the AOFM will generally keep its investment in these residential mortgage backed securities? Can this be anticipated in advance or is it invested for a fixed period?
9. Overall what has been the outcome of this process, particularly in terms of meeting the objectives outlined by the Treasurer in his media release of 26 September 2008?
10. Has there been any improvement of confidence in the Residential Mortgage-backed Securities sector?
11. Have there been any recent issuances of RMBS that have not required investment by the Australian Office of Financial Management? If so, how many and which ones?
12. Did the Australian Government seek Treasury advice regarding further allocation of funds in Residential Mortgage Backed Securities? If so, when and what advice was provided?

Answer:

1. The Treasurer announced on 26 September 2008 that he would direct the AOFM to invest in RMBS to promote competition in the mortgage market. The AOFM has

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completed its final round of investment mandates for the \$8 billion in the Treasurer's directions of October 2008.

2. There has been keen interest in the program from issuers and arrangers, and growing interest in RMBS from investors. Private investors purchased about one quarter of the securities in the December quarter 2008 compared to about three fifths in the December quarter 2009.
3. On 30 September 2009, the AOFM awarded the last mandates related to the \$8 billion of support announced in 2008. The closing date for submissions was 18 September 2009.
4. Prior to the Global Financial Crisis (GFC), securitisation was an inexpensive source of funding for smaller lenders, particularly non-ADI lenders. These lenders provided an important contribution to competition in the mortgage market. Following the dislocation of securitisation markets globally, Australian lenders were unable to access the RMBS market, and this source of funding was effectively closed off to them. In turn, this affected smaller lenders' ability to participate in the mortgage market and compete with the major banks.

The Government's \$8 billion investment in RMBS has assisted smaller lenders to raise funds while the RMBS market has been dislocated. This funding has enabled these lenders to maintain competitive interest rates, higher lending volumes, and higher market shares than would otherwise have been the case. The investment in RMBS also maintained the operational infrastructure which will help facilitate a faster recovery in this market once conditions in credit markets improve.

5. The Treasurer's 16 October 2008 Direction specified that the AOFM invest up to \$4 billion in RMBS issued by non-ADI lenders. The AOFM has invested around \$3,825 million in RMBS issued by non-ADI lenders. The non-ADI beneficiaries of the program were Challenger, FirstMac, Resimac, and Liberty Financial.
6. Each of the investment rounds employed selection criteria related to the objective of supporting competition in the residential mortgage market. Proposals received by the AOFM were ranked based on the selection criteria, with the highest ranking conforming proposals being awarded mandates.
7. All the mortgages within RMBS in which the AOFM has invested, have met minimum requirements applying at the time that the RMBS are issued. While the majority of the mortgages are expected to continue to meet AOFM minimum eligibility criteria, certain minimum requirements applicable at the time of issue may not be maintained.
8. Under the Treasurer's Directions of 3 October 2008 and 16 October 2008, the AOFM can hold or sell its RMBS portfolio at its discretion once conditions in the RMBS market have improved. The Directions also require that sales of RMBS should be undertaken without causing market volatility and that the AOFM gives regard to the objectives of the program, the expected return and risk of the securities, and the management objectives of its total portfolio. As such, the length of time the AOFM will hold its RMBS is not known at this time.
9. The \$8 billion investment in RMBS through the AOFM has enabled 13 smaller lenders to raise an average of over \$850 million each to fund new mortgage loans.

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This funding has enabled these lenders to maintain competitive interest rates, higher lending volumes and higher market shares than would otherwise be the case. The program has also facilitated private sector participation in the market. The private sector has purchased about \$3.5 billion of RMBS securities or about 30 per cent of the total amount of RMBS issued with the support of the AOFM.

10. Yes, the following are indicators of improved confidence in the RMBS market:
 - There has been a reduction in ‘distressed’ RMBS sales, a number of investors have returned to the secondary RMBS market, the secondary market overhang is much reduced, and risk spreads in secondary markets have fallen from over 450 basis points to as low as 130 basis points.
 - Private sector interest in RMBS is much improved. For example, when Resimac issued RMBS in December 2008, the AOFM purchased 82 per cent of the securities issued, including all of the longer-maturity tranches. In contrast, in October 2009 the private sector purchased about 80 per cent of the Resimac’s RMBS deal, including a majority of the long-maturity tranches. The private sector’s appetite for long-maturity tranches of RMBS issued by a non-ADI is a strong sign of investors’ growing confidence in the RMBS market.
 - Five RMBS issuances took place in the last four months of 2009 without the support of the AOFM. ME Bank raised almost \$2.3 billion in RMBS transactions, Bendigo Adelaide Bank raised \$1 billion and Westpac raised \$2 billion.
11. Yes. ME Bank priced three fully-private RMBS transactions in 2009: “Maxis”, “SMHL Securitisation Fund 2009-2” and “SMHL Securitisation Fund 2009-3”. Bendigo Adelaide Bank raised \$1 billion in “Torrens Trust 2009-3” and Westpac raised \$2 billion in “WST 2009-1”.
12. Yes. On 11 October 2009, the Government announced an extension to its investment in Australian RMBS to further support competition in Australia's mortgage market. On 30 November 2009, the Treasurer issued a direction to the AOFM to invest up to a further \$8 billion in Australian RMBS, which implemented his October announcement.