AUSTRALIAN BANKERS' ASSOCIATION INC.

Steven Münchenberg
Chief Executive Officer

Level 3, 56 Pitt Street
Sydney NSW 2000
Telephone: (02) 8298 0401
Facsimile: (02) 8298 0402

8 February 2011

Mr John Hawkins
Committee Secretary
Senate Standing Committee on Economics
PO Box 6100
Parliament House
CANBERRA ACT 2600
economics.sen@aph.gov.au

Dear Mr Hawkins,

Competition within the Australian banking sector

On 14 December 2010, the Australian Bankers' Association (ABA) appeared before the Senate Standing Committee on Economics and gave testimony to the inquiry into competition within the Australian banking sector. The ABA provides further information on questions on notice as requested.

Securitisation market

The ABA notes that prior to the global financial crisis (GFC) there was significant growth in the mortgage originator sector. By mid 2007, securitisation accounted for 20% of new housing loans in Australia. However, experience with securitised products overseas lead to a loss of investor confidence in Australian residential mortgage backed securities (RMBS). Lenders with business models relying on securitisation markets were significantly impacted. Major banks accounted for around 75% of housing lending. However, the major banks were able to fill the gap created by the withdrawal of the mortgage originators from the lending market. (We note that market share in terms of lending remained relatively constant for credit unions and building societies during the GFC, with more recent increases in market share.)

Despite the reduction in the number of lenders in Australia, we believe there has not been any meaningful change in the range of lending products available to Australian borrowers. In our submission to the inquiry, we provide evidence of competition within the lending market – for example, there are over 100 mortgage providers, which represents significantly more providers than other industries.

The ABA believes that it is important for initiatives to reinvigorate the securitisation market in Australia. However, initiatives aimed at rebuilding the securitisation market and efforts to re-establish a properly functioning market for securitised products must be mindful of allowing the market to evolve and innovate.

Cost and availability of funding

The ABA believes that there are a number of short-term and longer term initiatives that would address the costs and availability of funds for all participants, especially smaller banks.

Short-term initiatives: ABA has previously recommended that Government should extend investment support via the Australian Office of Financial Management (AOFM) into the Australian RMBS market. AOFM investment has been an important temporary measure to support the securitisation market during difficult global market conditions. (Therefore, we support a third tranche of $4 billion and believe this further investment commitment will be an important short-term measure to assist the securitisation market and smaller lenders and those business models reliant on this source of funding.)

Longer term initiatives: ABA has previously recommended that Government should establish a working group with banking industry experts to explore options, identify strategies and agree on actions to be taken to rebuild the securitisation market in Australia. (Therefore, we support the establishment of a Treasury lead group looking into options to address sources of funding, including securitised products.)

Rebuilding the securitisation market in Australia is essential not only in terms of addressing the availability and cost of funds for banks and promoting competition within the Australian banking industry, but also in terms of providing an alternative asset class to bank paper necessary for meeting the new liquidity standards. We consider some specific strategies could include:

(1) Accepting third party AAA RMBS paper as an asset under the new liquidity rules;

(2) Introducing a fee-based facility for providing Government support to the Australian RMBS market based on certain regulatory requirements;

(3) Establishing a Government corporation or market-based SPV to provide mortgage lenders with mortgage default insurance as credit quality enhancement; and

(4) Developing a new "bullet" RMBS security.

Establishing a benchmark

The ABA was asked to provide feedback on the idea of establishing a benchmark (or independent assessment) for securitised products. We note some commentators support establishing a set of minimum standards or benchmark for pools of securitised loans called 'Standardised Australian Mortgage Securities'. The proposed criteria would include certain tranche rules relating to the loans and the borrowers in the pool, the mortgage originator, the level of mortgages insured, and an equity capital requirement (retention requirement).

The ABA does not believe that independent benchmarks are necessary. We consider that investors set their own criteria in that certain instruments will/will not attract investors. Additionally, there are AOFM criteria (on repo eligibility), including:

- Residential Mortgages – max LVR at 80% at issue date
- Commercial Mortgage – max LVR at 60%

The ABA believes that independent benchmarks might stifle innovation. Having said that, we consider that international developments relating to structured finance products will be important in strengthening valuation processes and enhancing disclosure processes. Even though Australian RMBS is widely recognised as high quality with better performing underlying assets (loans), simpler structures and better transparency, discussion of certain regulatory requirements or criteria should be the subject of further consultation with industry experts.

Creating an exchange

The ABA was asked to provide feedback on the idea of establishing an exchange for trading 'Standardised Australian Mortgage Securities'. We note some commentators support establishing an on-exchange market for securitised products to improve liquidity and promote market making trading activities among participants.

The ABA does not believe that the establishment of an exchange would be of benefit to the securitisation market, and by itself would not create or enhance liquidity. We consider that the additional transaction costs associated with pre and post-trade infrastructure would likely have an adverse impact on the desirability of securitised products.

Concluding remarks

The ABA believes that in addition to the short-term and longer term initiatives outlined above, initiatives aimed at reducing unnecessary regulatory burden and compliance costs associated with the offer of financial products, such as disclosure documents, promoting access to financial advice, and improving levels of financial literacy will also lead to long term growth in the securitisation market.

The ABA would be happy to discuss any of the issues raised in our supplementary submission with you further. If you have any queries, please contact me or Diane Tate, Policy Director, on (02) 8298 0410: dtate@bankers.asn.au.

Yours sincerely

Steven Münchenberg