



21 August 2009

The General Manager
Indirect Tax Division
The Treasury
Langton Crescent
PARKES ACT 2600

Email: financialsupplies@treasury.gov.au

Dear Sir / Madam

**Submission on the Treasury Paper
"Consultation Paper on the Review of the Financial Supply Provisions"**

I refer to Treasury's paper entitled "Consultation Paper on the Review of the Financial Supply Provisions" ("**Consultation Paper**"). The due date for submissions in relation to the Consultation Paper was 31 July 2009. However, I refer to email correspondence on 28 July 2009 and 14 August 2009 between Mr Rob Dalla-Costa of your office and Mr Jeffrey Lum representing the Australian Securitisation Forum ("**ASF**"), in which Treasury agreed to extend the due date to 21 August 2009 for providing the ASF's submission.

In the Consultation Paper, Treasury invited interested parties to comment on various issues and options discussed in the Consultation Paper, including:

- replacement of the existing legislative framework with a principle or set of principles (Option 1);
- amendment of the existing law relating to financial supplies (Option 2); and
- revision of the extent of eligible reduced credit acquisitions ("**RCAs**") and rate of reduced input tax credits ("**RITCs**") (Option 3).

Treasury also sought comments on any alternative approaches for simplifying the current treatment of financial supplies whilst maintaining the same policy outcome.

We are grateful for the opportunity to make a written submission to Treasury on the Consultation Paper.

Background to the ASF

The ASF was formed in 1989 to promote the development of securitisation in Australia. As the peak industry body representing the securitisation market, the ASF performs a pivotal role in the education of government, regulators, the public, investors and others who have an interest or potential interest both in Australia and overseas, regarding the benefits of securitisation in Australia and aspects of the securitisation industry.

The Australian securitisation market enjoyed rapid growth over the last 10 - 12 years, until the global credit crisis struck in mid-2007. The size of the market, based on the values of securities outstanding by Australian securitisation vehicles, has increased from A\$10 billion in March 1995 to nearly A\$200 billion by the end of 2007.

Consistent with overseas securitisation markets, a large part of the growth of the Australian securitisation market has been in mortgage-backed securities, driven by both the banking and non-banking sectors.

In addition to residential mortgage loans, the types of assets that have been securitised to date in Australia include:

- Vehicle and equipment loans and leases
- Credit and charge card receivables
- Trade receivables
- Collateralised loan obligations
- Net interest margin (income streams)
- Commercial mortgage loans and leases

Summary of the ASF's submission

The ASF's comments on the Consultation Paper can be summarised as follows:

1. The replacement of the existing legislative framework of the financial supply provisions (Option 1) is neither necessary, appropriate nor feasible.
2. Certain aspects of the GST law, as applicable to the securitisation industry, can, and should, be clarified and improved by way of focused legislative amendments to the existing law (Option 2).
3. A specific example of legislative clarification that is required in the financial services context (i.e. Option 2) involves ensuring that wholly-owned securitisation structures are afforded a real and practical opportunity to take advantage of the GST grouping rules in the same way that other taxpayers are able to do so. In the ASF's view, the existing GST law does not adequately address the special features of entities that operate within these particular structures. We consider that legislative clarification is within the scope of the review contemplated in the Consultation Paper.
4. There would need to be *very clear evidence* that any revision to the reduced credit acquisition and RITC regime (Option 3) would better promote and achieve the overall policy intent than is the case under the current GST law. In the absence of such evidence, the ASF's view is that these aspects of the financial supplies provisions should not be disturbed. The 3 main factors relevant to the ASF are as follows:
 - (a) *Competitiveness* - To the extent that a change would increase the cost structures of securitisation vehicles (such a reduction in RITC rates and/or introducing multiple RITC rates in a way that increases compliance costs), this would reduce the competitiveness of securitisation as a funding source for both business and households. This would be clearly inconsistent with the Government's broader policy objectives to "promote the efficient operation of Australia's financial markets and to ensure robust competition in the mortgage market to put downward pressure on mortgage interest rates".

- (b) *Simplicity* - A key objective of any review by Treasury should be to facilitate simplification of the GST law and to ensure that the legal rules are designed and drafted in terms ways that can be administered as simply as possible. In this context, it would seem that any proposal involving the introduction of multiple RITC rates would not be desirable.
- (c) *Implementation* - The categories of reduced credit acquisitions and the 75% RITC rate have been key features of the Australian GST regime, and any change to these key features would require a significant devotion of time, cost and resources by taxpayers. In the current economic climate, such a large-scale change would be most undesirable, and certainly not feasible.

Promoting competitiveness of the securitisation industry is of utmost importance to the ASF. Therefore, any preference for maintaining a single RITC rate would be subject to that rate not being reduced, especially in a manner that is detrimental to the overall competitiveness of the industry.

The main categories of reduced credit acquisitions that are typically relied on by participants in the securitisation industry consist of trust management services (item 23(b) of the table set out in sub-regulation 70-5.02(2)) and loan management, collection and servicing (items 14, 15 and 17 of the table set out in sub-regulation 70-5.02(2)). These services are high "value-add" in nature. In these circumstances, the appropriate rate of RITC should be at least 75% for these particular services and potentially much higher. In the ASF's view, it would be very difficult to justify a reduction in the RITC rate applicable to those categories from a policy perspective.

As discussed with Treasury, this letter outlines the ASF's high-level comments on the Consultation Paper on the expectation that Treasury would consider a more detailed submission from the ASF with form and content to be further discussed. The ASF would be happy to discuss any specific requirements (including numerical analysis on possible impacts on the securitisation industry as a whole) that would assist Treasury in conducting its broader review of the financial supply provisions.

Further details of submission

1. Option 1 not feasible

The implementation of any significant change to the current GST regime, such as the replacement of the existing legislative framework, would be extremely costly for participants in the securitisation industry who operate on the basis of pre-defined cost structures and margins. Due to the expected high costs of implementing any change and the resulting uncertainty associated with the impact on securitisation structures, Option 1 is not considered by the ASF to be appropriate or feasible.

There may arguably be scope for overall improvement to the design, operation and administration of the current GST law. However, with the Australian GST implemented for almost 10 years and the current regime so entrenched in the functions, pricing, systems and processes of taxpayers, the ASF's view is that a fundamental redesign of the GST law is neither warranted, appropriate nor feasible.

2. Option 2 is generally more appropriate

Certain aspects of the GST law (as applicable to the securitisation industry) can, and should, be clarified and improved by way of focused legislative amendments to the

existing law. This approach (as distinct from Option 1) would provide greater certainty and enable taxpayers to better prepare for applying and implementing legislative amendments.

Should Treasury wish to receive a more detailed submission from the ASF setting out specific changes that are relevant to the securitisation industry, please let us know.

3. Option 2 – specific example

One specific example of legislative clarification that is required in the financial services context involves ensuring that wholly-owned securitisation structures are afforded a real and practical opportunity to take advantage of the GST grouping rules in the same way that other taxpayers are able to do so. This would appear to be consistent with the policy intent of the GST grouping rules.

However, such an opportunity has not generally been available due to the limited scope and operation of the current GST grouping rules. In the ASF's view, the GST grouping rules currently do not adequately recognise and take into account specialised and unique financial services arrangements such as securitisation vehicles.

Further details of the need to clarify the GST grouping rules have been the subject of a separate submission by the ASF to Treasury dated 19 June 2009, a copy of which is accessible at the following link

http://www.treasury.gov.au/documents/1578/PDF/Australian_Securities_Forum.pdf

Due to the adverse impact on participants within the financial services industry, it is the ASF's submission that such legislative clarification is clearly within the scope of the issues sought to be addressed by the Consultation Paper and should therefore be addressed as part of this review.

Such action would also be consistent with broader Government policy in ensuring competitiveness of participants involved in the RMBS market, as outlined in our previous submission.

4. Option 3 not appropriate

The stated policy intent of the reduced credit acquisition and RITC regime is to correct the "outsourcing bias". To the extent that Treasury is considering any significant changes to the GST law such as revising the RITC rate, the ASF considers that there would need to be very clear evidence that any such revision would better promote and achieve the overall policy intent than is the case under the current GST law.

In the absence of such evidence, the ASF's view is that these aspects of the financial supplies provisions should not be disturbed.

In this context, there are 3 important factors influencing the ASF's position, as outlined below:

(a) Competitiveness

On 26 September 2008, the Treasurer in Press Release No. 105 announced a Government initiative under which the Australian Office of Financial Management

would purchase up to \$8 billion of Australian residential mortgage-backed securities (“RMBS”). This was stated to be “part of the Government’s commitment to strong and effective competition in Australia’s mortgage markets”.

In that Press Release, the Government also stated that:

- “[t]he Rudd Government is committed to ensuring that Australia's financial markets continue to perform strongly and provide Australian households with a wide range of financial products at competitive prices”;
- “[s]ince the deregulation of the financial system in the 1980s and 1990s, the RMBS market has provided an important source of funding for new and smaller mortgage lenders to compete with the major banks”;
- the purchase of RMBS would “reinvigorate the Australian RMBS market and support competition in mortgage lending”;
- the purchase of RMBS would be “a temporary initiative that responds to highly unusual conditions in international capital markets and their impact on Australia's mortgage lending market”; and
- the initiative “demonstrates the Government's determination to promote the efficient operation of Australia's financial markets and to ensure robust competition in the mortgage market to put downward pressure on mortgage interest rates”.

To the extent that Treasury is considering any particular change that would have the effect of increasing the cost structures of securitisation vehicles, this would further reduce the competitiveness of participants in the RMBS market and could indeed have an adverse impact on the viability of certain structures. Such outcomes would be clearly inconsistent with the Government’s broader policy objectives as described above.

For this purpose, examples of outcomes that could increase cost structures include:

- decreasing the current RITC percentage to below 75%. This would have a clear and direct adverse impact on cost structures;
- decreasing the current RITC percentage for certain types of acquisitions only to below 75%. This would have a clear and direct adverse impact on cost structures, particularly where the RITC percentage is reduced for the main types of acquisitions that are more relevant to securitisation (e.g. management, commission-based and trustee services); and
- increasing the overall complexity of the RITC regime through measures such as multiple RITC rates. In addition to potentially increasing the underlying costs of non-recoverable GST, there would also be associated compliance costs in characterising and applying different GST treatment to various types of acquisitions).

It seems clear that the ASF would not support changes to the GST law that are in the nature of those described above.

Any legislative amendments that have the effect of increasing the cost structures under securitisation arrangements would reduce the competitiveness of securitisation as a funding source for both business and households.

(b) Simplicity

The application of a new tax such as GST to unique and complex transactions, structures and entities within the financial services industry, especially the securitisation industry, has created difficulties for all participants operating within the industry. This has translated into greater underlying costs associated with non-recoverable GST, costs of compliance, administration and managing ATO compliance activity.

In this context, a key objective of any review by Treasury should be to facilitate simplification of the GST law and to ensure that the legal rules are designed and drafted in terms that can be administered as simply as possible.

In promoting simplicity, it would seem that any proposal involving the introduction of multiple RITC rates should be resisted. This would particularly be the case where there would be no obvious impact on overall GST revenue (i.e. there is no reason from a "cost-benefit" perspective).

(c) Implementation

The categories of reduced credit acquisitions and the 75% RITC rate have been key features of the Australian GST regime for almost 10 years and are firmly entrenched in cost structures, margins, systems and processes for all participants in the financial services industry, including the securitisation industry.

Any change to these key features would require a significant devotion of time, cost and resources by taxpayers. Such an exercise would be broadly analogous to the original implementation of GST in 2000. In the current economic climate, such a large-scale change would be most undesirable, and certainly not feasible.

Promoting competitiveness of the securitisation industry is of utmost importance to the ASF in preparing this submission. Therefore, the ASF's preference to retain only 1 RITC rate (for simplicity and to reduce the cost of implementation etc) is subject to that rate not being reduced, particularly in a way that is detrimental to the overall competitiveness of the securitisation industry.

In any case, the reduction of the RITC rate may not be consistent with underlying policy objectives. For example, the main categories of reduced credit acquisitions that are typically relied on by participants in the securitisation industry consist of trust management services (item 23(b) of the table set out in sub-regulation 70-5.02(2)) and loan management, collection and servicing (items 14, 15 and 17 of the table set out in sub-regulation 70-5.02(2)).

The above categories of reduced credit acquisitions refer to services that are high "value-add" in nature. In these circumstances, the appropriate rate of RITC should be at least 75% for these particular services and potentially much higher. The ASF's view is that it would be very difficult to justify a reduction in the RITC rate applicable to those categories from a policy perspective.

Should Treasury require specific analysis in the course of reviewing the current RITC rate as applicable to the above categories (or other categories that may be relevant to the securitisation industry), we would welcome the opportunity to provide further input or assistance.

Next steps

As discussed with Treasury, this letter outlines our high-level comments on the Consultation Paper on the expectation that Treasury would consider a more detailed submission from the ASF with form and content to be further discussed. The ASF would be happy to discuss any specific requirements that would assist Treasury in conducting its broader review of the financial supply provisions. Requirements to be discussed could include:

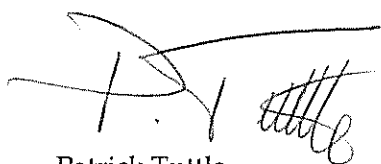
- numerical analysis on levels of RITC rates that would better achieve the objective of reducing outsourcing bias; or
- other analysis aimed at assessing potential impacts of change to the financial supply provisions, reduced credit acquisitions and RITC rate on the securitisation industry as a whole.

In the meantime, we would welcome an opportunity to meet with Treasury to discuss the current GST issues faced by the securitisation industry and the ASF's comments in this submission.

The ASF would also greatly appreciate an opportunity to participate in any further consultative process with Treasury in relation to proposed changes to the financial supply rules, list of reduced credit acquisitions and/or the RITC rate.

Should Treasury wish to discuss this submission with a representative of the ASF, please do not hesitate to contact me on (02) 9463 4612.

Yours faithfully



Patrick Tuttle
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Taxation Committee
Australian Securitisation Forum