

CHAIRMAN'S REPORT

Welcome to the new quarterly publication from the Australian Securitisation Forum (ASF).

The magazine has been designed to provide information on what is happening in our very exciting Australian securitisation industry and to keep readers informed of developments occurring in the overseas financial markets.

Development of this magazine is part of the implementation of a five-year strategic plan for the ASF that identified communication as being one of the key functions of the ASF. Production of this quarterly Forum magazine, together with re-development of the ASF website, are two of the areas where you will see the results of the implementation of this communication strategy.



Education is also a key strategy and next year will see the implementation of a Diploma of Securitisation, that builds upon the very successful *Introduction to Securitisation* and *Advanced Securitisation* courses introduced this year.

The ASF will continue to maintain strong links with the American and European Securitisation Forums through dialogue on industry

issues that impact us together and through supporting each of our annual securitisation conferences. The American ASF conference is being held on 28 – 30 January and Australian ASF members are being offered discount registration fees to attend. Details are on the American Securitisation web site.

As we look back on 2006, we will probably see a record year for Australian securitisation, with increased issuance across all sectors of our industry. That increase in volume this year has also been seen in the international markets, as the financial sector sees increasing opportunities arising from the implementation of Basel II.

By the time you read this magazine, we will be well underway in our 5th annual Australian securitisation conference – the first one run for and by the Australian securitisation industry. We know it will be a success and we thank all the supporters and sponsors who have made it such an essential part of our annual calendar.

Going forward into 2007, we see continued strength in our industry, both in Australia and offshore. We anticipate increased volume of issuance, particularly in the asset-backed securities, commercial mortgage-backed securities and collateralised loan obligation sectors as well as continuance of the high levels of residential mortgage-backed securities.

Your ASF will continue to represent the Australian industry as well as providing the education opportunities for new participants. We are always seeking new participants in the sub committees to help us meet these goals.

On behalf of the ASF I wish all of you a very happy Christmas and a very successful new year.

Roger Desmarchelier
Chairman, ASF

Asset-backed commercial-paper (ABCP) on issue in the Australian and New Zealand ABCP markets rose by 1.0 per cent to A\$55.1 billion (US\$42.4 billion) in August from A\$54.5 billion in July 2006, according to Standard & Poor's (S&P).

The total number of programs remained at 59 in August with an 'A-1+' rating being assigned to Babcock and Brown's A\$1 billion Ancora Securitisation (SF) Pty. Ltd. ABCP program. According to S&P, this program has the benefit of an irrevocable letter of credit that insulates investors against credit and liquidity risk.

Meanwhile, on August 23, 2006 Citibank's Prime Asset Vehicle Ltd. Series 4 was retired and the 'A-1+' rating was withdrawn.

Residential mortgages continue to dominate assets funded by ABCP, representing 50.5 per cent of the market. However, S&P notes that recently there's been a decline in the number of residential mortgage-backed securities (RMBS) assets being funded through ABCP programs due to the downward pressure on margins. As a result, collateralised debt obligations (CDOs) are becoming more frequently acquired by CP conduits due to their higher yields.

In August, residential mortgages/RMBS continued to account for over half of the ABCP market, representing 67.5 per cent. Infrastructure bonds accounted for 6.9 per cent of the market, followed by auto/equipment loans/leases at 6.46 per cent and margin loans at 3.69 per cent.

SLIGHT RISE IN SEVERE ARREARS

Severe arrears in residential mortgage loans underlying prime Australian RMBS transactions increased slightly in August 2006, according to S&P.

S&P surveillance analyst Sarah Raisbeck reports that residential mortgage loans in arrears by more than 90 days rose to 0.43 per cent in August, the highest level seen to date.

But she adds: "The deteriorating trend in more severe arrears may not be as bad as it first appears. Lenders are now taking longer to recover on defaulted loans, due to softer property prices, which mean that borrowers in arrears will remain in the reported arrears statistics for longer periods."

Overall, however, Raisbeck notes that there was a marginal improvement in arrears on residential mortgage loans in August. Loans in arrears by more than 30 days fell to 1.1 per cent in August, down from 1.14 per cent in July, as measured by the Australian Prime Standard & Poor's Mortgage Performance Index (SPIN).

"More borrowers are finding it harder to recover when they fall behind in their loan repayments. The higher fuel prices and interest rates have contributed to the financial pressures facing borrowers," she says.

Raisbeck says after two consecutive months of decline, arrears on Australian prime low documentation (low doc) loans rose in August to 2.14 per cent (from 2.08 per cent in July). In addition, arrears on Australian prime full documentation (full doc) loans fell to 0.95 per cent in August, from 1.00 per cent in July.

Meanwhile, arrears greater than 30 days on loans underlying Australian subprime RMBS increased to 11.43 per cent over the month of August, up from 11.2 per cent at the end of July.

REVERSE MORTGAGE MARKET DOUBLES

A study of the Australian reverse mortgage industry has found that this sector has doubled its value in the last 18 months as its products gain popularity.

The study, conducted by actuarial firm Trowbridge Deloitte on behalf of the Senior Australian Equity Release Association of Lenders, SEQUAL, found that the Australian reverse mortgages book currently stood at A\$1.1 billion, more than double the A\$459 million at the end of 2004.

SEQUAL executive director Kieren Dell says the trend is a sign of things to come. "Reverse mortgages are steadily growing as a retirement financial planning tool. I expect the level of outstanding loans to be close to \$1.4 billion by the end of 2006," he comments.

GLOBAL CDO VOLUMES ON THE UP

Global CDO issuance for the first three quarters of 2006 topped US\$322 billion, outstripping issuance for the whole of 2005 by 20 per cent, according to the US's Bond Market Association (BMA).

And, at US\$117.8 billion, issuance in the third quarter of 2006 was 30 per cent higher than issuance in the third quarter of 2005.

The BMA attributes these increases to a relatively strong

corporate performance and a large supply of loans, combined with the increasing size of the investor base and the flexibility provided by synthetic structures.

Cash flow and hybrid CDOs, with issuance of US\$90.1 billion, accounted for over 75 per cent of issuance in the third quarter, the largest sector in terms of structure. Arbitrage CDOs, at US\$106.9 billion, were the largest deal type in terms of the motivation for the transaction.



ARREARS IN NEW ZEALAND FALL

Arrears on prime residential mortgage loans funded through RMBS in New Zealand fell again in August, to 2.9 per cent, as measured by S&P's New Zealand Prime SPIN. This is the lowest level reported since December 2005.

The fall in prime arrears saw arrears on both prime low doc and

prime full doc loans fall. The level of arrears on residential mortgage loans underlying New Zealand subprime RMBS also fell to 9.8 per cent in August 2006.

By the end of October, there were eight prime deals outstanding (NZ\$1.13 billion) and five subprime deals (NZ\$0.56 billion).

FITCH LAUNCHES NEW RATINGS AGENCY

Fitch Ratings (Fitch) has launched a specialist rating agency to focus on the specific needs of the credit derivatives market.

Called Derivative Fitch, it will provide the credit derivatives market with ratings, research, analytics and evaluation services that address the unique risks of the market.

Fitch notes that the structural complexity of the credit derivatives market is quite different to that of the traditional bond market. This is because these instruments and securities are affected not only by risk associated with underlying assets but also heightened sensitivities to factors like credit stability and market risk.

It adds that while the role, use and performance of credit ratings are well defined in the traditional bond markets, questions are increasingly being raised as to whether traditional ratings alone completely address the risks inherent in the credit derivatives market.

In response, Fitch has seconded over 100 professionals from its global collateralised debt obligation) and structured credit ratings groups and related complimentary products, analytics and modelling groups to focus exclusively on the credit derivatives market.

They have been gathered from its New York, London, Hong Kong, and offices in other major financial centres around the world.

TRUE BLUE TRANSPARENCY

Australia remains the most transparent country in the world in terms of real estate investment, but rising securitisation levels and higher cross-border flows are forcing several other markets to improve their transparency, according to the Jones Lang LaSalle's 2006 Real Estate Transparency Index.

Jones Lang LaSalle's head of research and consulting, Kathryn Matthews says: "Australia sets the world standard for transparent and sophisticated real estate markets but over the last two years we have seen significant improvements in many other parts of the globe."

She says overall, 14 of the 56 countries surveyed have moved up a full tier and none have moved down in terms of transparency.

Following Australia, the most transparent markets are the US, New Zealand, Canada and the UK.

In the Asia Pacific, Japan has moved from semi-transparent status in the 2004 report to the lower end of transparent in 2006.

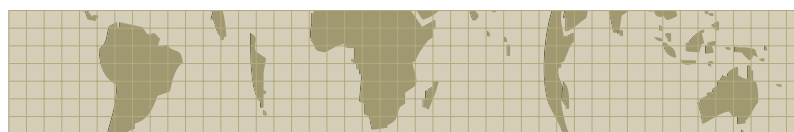
Matthews attributes this change to the rapid development of

the J-REIT, expansion of listed trusts with Japanese assets, higher levels of international penetration, improvements in taxation transparency and greater enforceability of contracts."

India has also improved from a very low base. "A flood of major retailers and other MNCs looking to capitalise on India's recent exceptional economic growth, plus an increasing presence of international property consultancies, has significantly improved the quality and availability of market information across all sectors," says Matthews.

"Similarly, foreign investors have encountered improved general accounting and reporting processes as local Indian firms start to match the standards set by firms reporting internationally. There has also been substantial improvement in the general market understanding about the legal processes, however, overall the market remains at the bottom of the semi-transparent tier."

Other Asia Pacific markets showing improved transparency are Malaysia, Taiwan and South Korea.



ASIA-PACIFIC REGION HUNGRY FOR CLOs

The fledgling Asia-Pacific region is seeing an increasing number of CLO transactions, according to Derivative Fitch.

Derivative Fitch's Asia-Pac structured credit team notes that the market for CLOs in the region is quite young. Nonetheless, the CLOs that have emerged so far are balance sheet synthetic transactions in Singapore and Australia, as well as domestic cash CLOs in Taiwan. Taiwanese banks are realising the benefits of originating CLOs, allowing them to unload risk off their books and make more loans.

inbrief

ABCP CONTINUES TO CLIMB

US ABCP standings climbed to US\$993.1 billion at the end of September, according to rating agency Fitch.

In addition, ABCP issuance as a percentage of total US CP continued to climb, rounding out at 53.3 per cent. The total amount of CP outstanding at the end of September was US\$1.86 trillion, a rise of US\$27.5 billion, or 1.5 per cent over the August level.

The US Federal Reserve reported ABCP outstanding as more than \$1 trillion on 11 October. As of 18 October, the total amount of US CP outstanding was about US\$1.87 trillion, while the total amount of ABCP outstanding equalled US\$990.5 billion.

NEW ASSOCIATION TO DEVELOP ASIAN CAPITAL MARKETS

The first regional industry body aimed at promoting the development of Asia's capital markets was launched in Hong Kong in October.

Called the Asia Securities Industry and Financial Markets Association (ASIFMA), the new industry body will also focus on the orderly integration of Asia's capital markets into the global financial system.

"Building deeper and more liquid domestic capital markets will provide Asia with the kind of large scale financing the region needs to sustain its exceptional growth," notes Anthony Iliya, co-chair of ASIFMA and managing director and executive vice chairman of asset management for Asia Pacific at Credit Suisse.

"We look forward to helping standardise market practices and working with regulators to create a more stable, transparent regulatory environment, which in turn will foster the growth of the capital markets."

ASIFMA plans to focus on markets in China, Hong Kong, India, Indonesia, Korea, Malaysia, Philippines, Singapore, Taiwan and

Thailand. It will advocate on behalf of its members and markets and will work to promote robust investor protection rules, standardisation of market practices, and the principal of self-regulation. In addition, it will work on harmonising regulations and standards across the regional and global financial markets.

"Local market practices and regulation need to be more consistent, where possible, with proven and well-settled practices in Europe and North America," notes Nicholas de Boursac, ASIFMA.

REAL ESTATE RECORDS

Global direct real estate investment topped US\$290 billion in the first half of 2006, up 30 per cent on the same period in 2005, with the Americas, Europe, and Asia Pacific enjoying unprecedented levels of transactions, according to a report from Jones Lang LaSalle.

Jones Lang LaSalle's international capital group chief executive officer, Tony Horrell, notes: "Real estate markets are continuing their strong evolution into a global asset class, with cross-border investment now representing 44 per cent of total volumes, compared with 34 per cent for the first half of last year.

"The real proof of this globalisation is that inter-regional investment, meaning transactions involving parties not from the region where the asset is located, now represent 31 per cent of total volumes (US\$89 billion), up from 24 per cent a year ago."

Horrell notes that indirect funds, principally real estate investment trusts (REITs), valued at almost US\$30 billion were privatised in the US.

"This is not a trend we are witnessing elsewhere. Indeed more countries are planning to introduce REITs in the near future, including the UK and Germany," he says.

GINNIE TO SECURITISE REVERSE MORTGAGES

Ginnie Mae is developing a new type of MBS entirely backed by reverse mortgages, the first of which will be issued in September next year. Called the Home Equity Conversion Mortgage Mortgage-Backed Security (HECM MBS), it will allow approved issuers to securitise and sell their Federal Housing Administration (FHA) insured home equity conversion mortgage loans in the form of a Ginnie Mae MBS.

The Ginnie Mae HECM MBS will provide the MBS marketplace with a full faith and credit vehicle for the securitisation of HECMs.