



The Australian Mortgage Backed Securities market.

Is an enhanced model needed to lower mortgage rates?

Media briefing by Greg Medcraft, The Australian Securitisation Forum
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Agenda

- The ASF position
- Current environment
- Canadian model - How it works
- Comparative benefits of the Canadian model
- Other benefits of the Canadian model
- Next steps



The ASF position

- ASF has reviewed MBS models around the world
- The Canadian MBS model has significant benefits to offer the Australian market
- ASF is proposing to set up a taskforce to explore how the Australian MBS market could be enhanced
- Expected benefits of enhancements include:
 - Liquidity
 - Lower mortgage rates to borrowers
 - Improved investor confidence



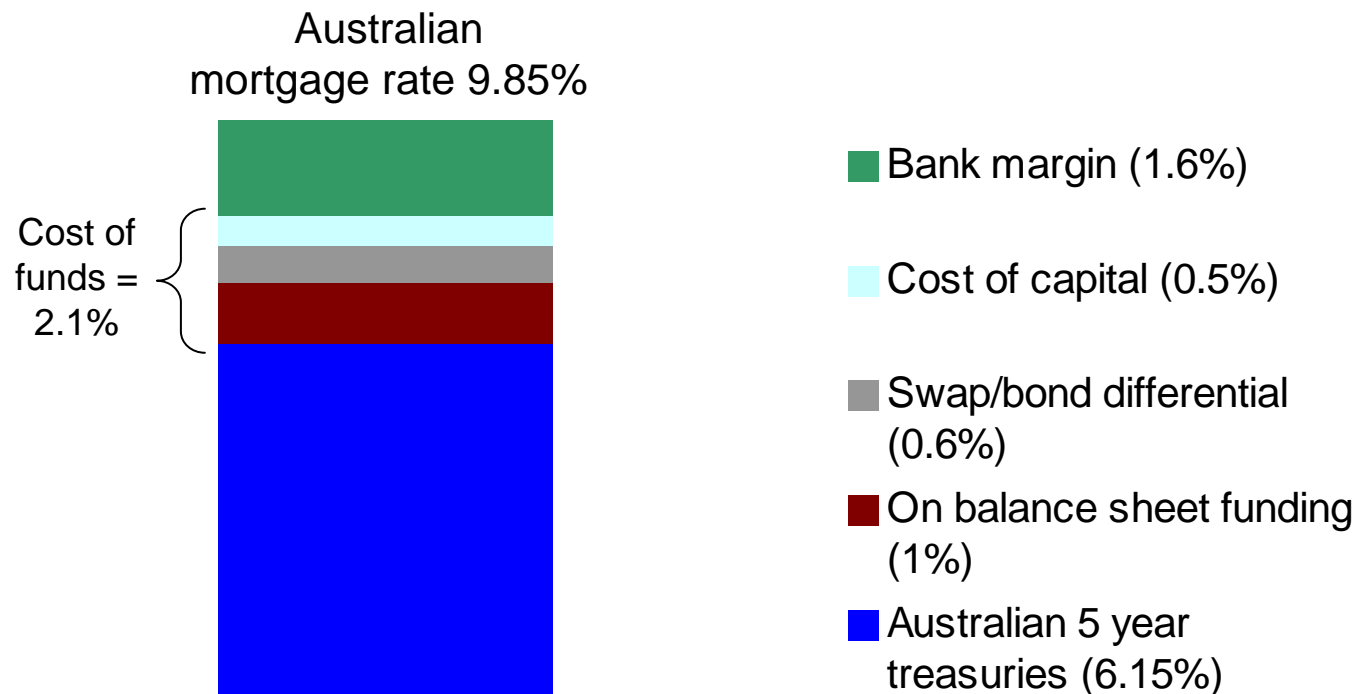
The current Australian environment

- The credit crisis is driving up cost of funds and mortgage rates
- The MBS market in Australia is currently frozen
- Non bank players are withdrawing from the market
- Declining competition and liquidity
- Credit rationing



The current Australian environment

- Increasing cost of funds



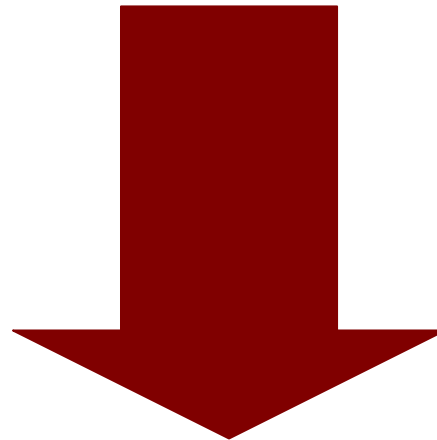


The current Australian environment

- Declining issuance of Australian RMBS

1 Jan - 30 June
2007

A\$45 billion
(issuance total)



1 July - 31 Dec
2007

A\$6 billion
(issuance total)

Source: Reserve Bank of Australia's *2008 Financial Stability Review*





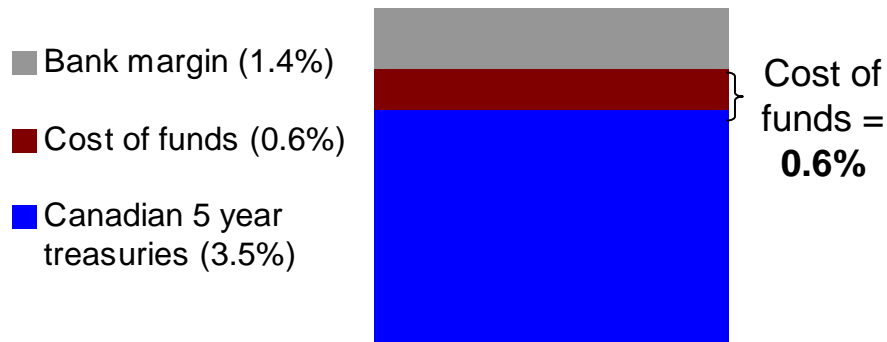
Learning from the Canadian experience

- Canada adapted US model for its market over 20 years ago
- The model was evolved in 2001 to address investor concerns and improve liquidity
- Canadian MBS market is highly liquid
- Canadian homeowners enjoy comparably low mortgage costs

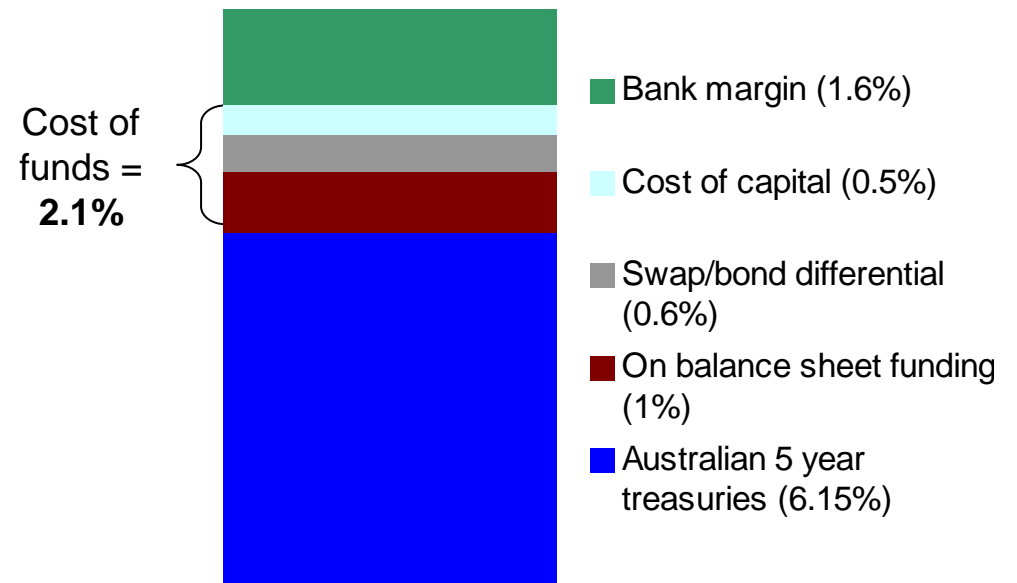


Canadian home owners enjoy lower mortgage costs

Canadian mortgage rate 5.5%



Australian mortgage rate 9.85%



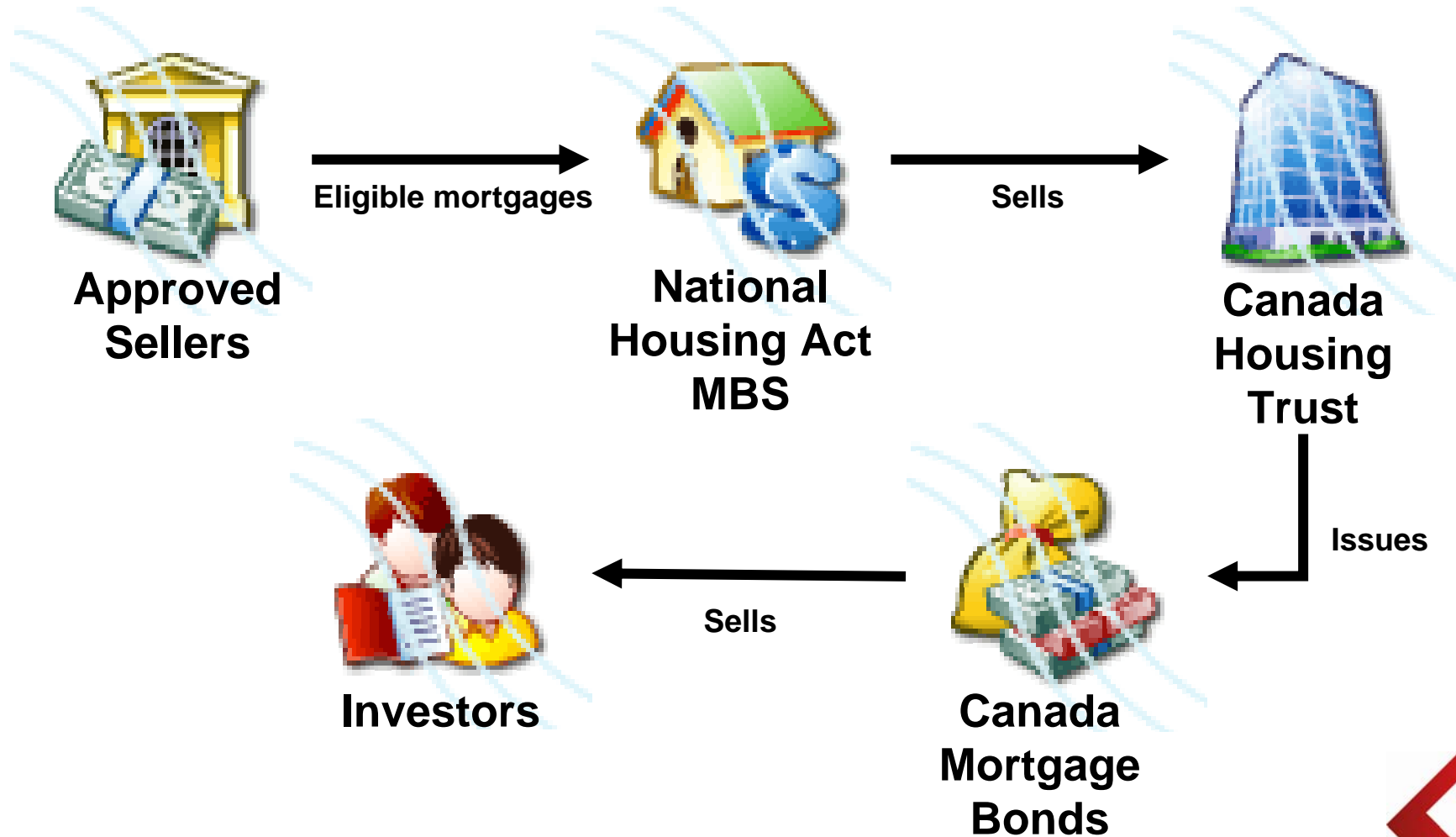


Background

- The National Housing Act MBS program was introduced in 1985 to
 - create competition
 - provide investors with high quality, government guaranteed MBS that are secured by property supported by mortgage insurance
 - lower mortgage rates to the consumer
 - strengthen the solvency of the financial system



How it works





Issuers/sellers are approved

- Approved issuers include banks, life insurance companies, credit unions and dealers
- CMHC guarantee timely payment of principal and interest on MBS issued by approved issuers backed by eligible mortgages
- Approved issuers must have:
 - a net worth of at least CAD\$3 million
 - 2% of the principal amount of NHA MBS outstanding as a buffer
 - relevant experience, management capability and infrastructure



Mortgages must follow eligible criteria

- To be eligible a mortgage must be a
 - first mortgage
 - owner-occupied property
 - maximum amortization of 40 years
 - mortgage insurance from an approved mortgage insurer (AIG, GE, PMI and CMHC itself)
 - not delinquent and fully funded
 - equal principal and interest payments
 - at least monthly payments



Pools of eligible mortgages are created

- Approved issuers create pools of eligible mortgages which are issued as NHA MBS
- To be eligible each pool must have:
 - a minimum portfolio value of \$2mil
 - each individual loan must not exceed 25% of the total pool
 - contain mortgages that mature no sooner than six months prior to bond maturity
 - all loans insured by one insurer
 - interest rate requirement



NHA MBS are issued

- Issuers pass through to investors principal plus the coupon payable on the MBS each month
 - Issuance coupon on prepayable NHA MBS have averaged around 0.45% over the relevant Canadian Treasuries
- The CMHC guarantee underpins liquidity and lowers funding costs
- CMHC charges 0.2% guarantee fee at issuance
- NHA MBS outstandings are CAD\$141 billion (representing 18% of mortgages outstanding (30/9/07))
- Australian MBS outstanding at the same date was A\$173 billion



Canada Mortgage Bond introduced

- Model enhanced in 2001 to increase liquidity and address investor concerns
- CMB introduced
 - 3/5 year semi-annual coupon fixed or quarterly coupon floating rate bullet maturity bond
 - guaranteed by CMHC
 - included in the major fixed income index (Universal Bond Index)
- NHA MBS and CMB are zero risk weighted for capital adequacy and repo eligible with the Bank of Canada



CMB issuance process

CMB issued quarterly by Canadian Housing Trust (CHT) managed by CMHC



Proceeds buy newly created NHA MBS offered by approved issuers



CHT enters into a swap with eligible counterparty (minimum credit rating of A)



Eligible counterparty receives interest and principal monthly on the NHS MBS and pays the CMB coupon



Eligible counterparty reinvests principal in eligible investments (which include NHA MBS) until maturity of the CMB



CMBs drive investor demand

- As at 30/9/07, 78% of NHA MBS outstandings were repackaged as CMB
 - CMB outstandings equal CAD\$109.5 billion (CAD\$105 billion are fixed rate)
- In 2001, NHA MBS outstanding was CAD\$34 billion with a 7.8% share of mortgages outstanding
 - 18% now



Comparative benefits of the Canadian model

- A proven source of long term, low cost capital market liquidity
- Competition and consumer choice
- Lower mortgage rates to borrowers
- Investor confidence underpinned by government guarantee
- Canada Mortgage Bonds have an investor driven payment and issuance structure
- Less reliance on offshore debt markets
- Allows for broader supervision of the mortgage lending sector
- Market transparency
- Reduced risk of credit rationing



Other benefits of the Canadian model

- Limited budgetary impact
- Implementation would be straight forward
- Public/private sector model



Next steps

- ASF will be developing an industry taskforce
- Nominations will be called for in the near future
- Commence a dialogue with appropriate governmental, regulatory, accounting and other policy making bodies
- Educate and achieve consensus on enhancements to the Australian Mortgage backed Securities market



Conclusion

- Australian homeowners would benefit from mortgage market enhancements
- The Canadian MBS model has features that would benefit the Australian market
- The ASF will work with key players to build consensus and drive reform