

THE AUSTRALIAN BUSINESS SECURITISATION FUND IN A NUTSHELL

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Highlights

In face of the current status quo, where the big four banks in Australia account for over 80% of small business lending, often charging higher rates and imposing tougher conditions to grant these borrowers access to credit, the Australian Business Securitisation Fund comes as an alternative to facilitate the non-bank lenders' participation in this market and to promote more competition/liquidity and therefore better conditions for SMEs to secure a loan.

The creation of the fund is in early stages and the characteristics of the pool of assets and structure of the warehouses/securitisation deals that will be accepted/prioritised in the investment decisions are still not clear. In this report, Moody's Analytics presents a summary of what the new policy represents and what it entails.

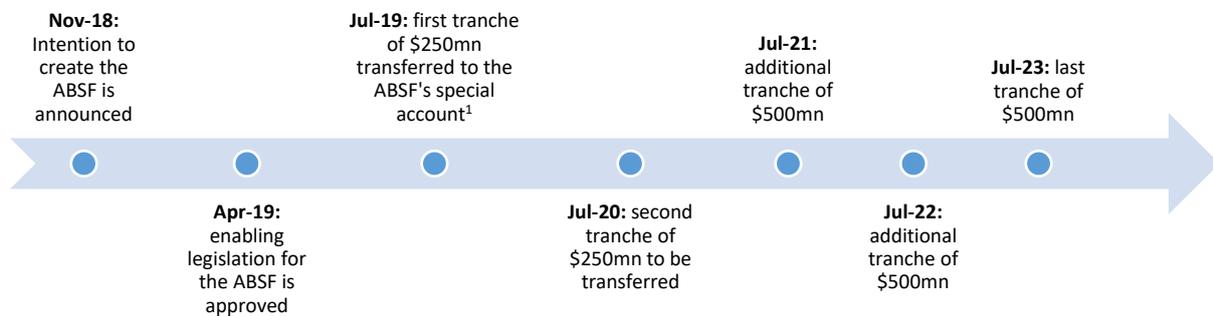
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1. AUSTRALIAN BUSINESS SECURITISATION FUND

The Australian Business Securitisation Fund (ABSF) is a \$2 billion taxpayer-backed fund aiming to boost competition in the small to medium enterprises (SMEs) lending market – in other words, increase the availability and/or reduce the cost of credit provided to small business owners. It will be administered by the Australian Office of Financial Management (AOFM) and will target investments in securitisations of loans made by SME eligible lenders, via warehouse facilities or term deals. The expectation is that the development of market infrastructure to nurture the securitisation of SME loans can become an important component to attract additional (private) capital to the sector over the longer run.

2. CHRONOLOGY



¹ Although \$250 million is already available for investment in the current financial year, AOFM is still to call for proposals. The transaction assessment process is not yet finalised as an Investment Manager for the purpose has not been hired.

3. DEFINITIONS

Authorised Debt Securities

As stipulated by law, the fund can only invest in authorised debt securities:

- Issued by: (i) a trust or (ii) a special purpose vehicle
- Expressed in Australian dollars (AUD)
- Related to secured or unsecured credits of a maximum of \$5 million each provided to debtors wholly or predominantly for business purposes – loans should not predominantly relate to businesses with a primary purpose of investing, such as superannuation funds
- Related to credits not provided by: (i) a major bank or (ii) a subsidiary of a major bank, being a major bank a deposit-taking institution subject to the Major Banking Levy Act 2017
- Not related to first loss securities – avoiding investment in first loss securities reduces risk and moral hazard for the Fund
- Compliant with any other requirements or restrictions to be prescribed by the rules

Investment Decision-Making Strategies and Criteria

Investment decisions will follow the below priorities:

- Investments in underdeveloped sectors of the SME securitisation market – there is a lot of confusion on what “underdeveloped sectors of the SME securitisation market” means. Some market participants assumed this is likely to mean focus on loans coming from industry sectors representing a bottleneck to production and/or productivity. Others understood that it might refer to the number of products available or players with capacity to lend for SMEs
- Investments that will help on the long-term development of the SME securitisation market
- Investments that attracts the private sector into investing in the SME securitisation market
- Investments that are likely to promote competition between providers of credit to small and medium enterprises
- Investments in debt securities that do not relate wholly or predominantly to credit provided for investments in financial assets or residential properties

In addition to the priorities listed, the following must be considered:

- Whether an investment in a security whose rate of return expected is lower than the market rate is really required
- Whether the investment will affect the ability of the Fund to exit the SME securitisation market in the long-term without significant market disruption

Investment Risk and Return

The financial return on the investments of the ABSF is the net return which is the return after management costs and any credit losses have been deducted and the Fund should:

- Have an acceptable but not excessive level of risk

Achieve over the medium term (5-10 years) a net financial return not lower than the AusBond Treasury 0-1 Yr Index

4. GUIDELINES

Due to the heterogeneous nature of the market, the AOFM will be taking a principles-based approach to act as assessment criteria against which investment proposals will be evaluated. The principles are grouped under two categories: [market impact](#) and [risk management](#) and will serve as a reference for initial assessments in order to produce a shortlist for investment decisions.

How Assessments Will Work?

AOFM will provide more detailed instructions once it calls for proposals. This is likely to include both an invitation to proponents to directly address the investment principles and a request for a description of the lender’s operating model, product range and market coverage, including both qualitative and quantitative information regarding

loans under management, such as loan book size, historic arrears and loss rates, the range of interest rates charged and a breakdown of security types. Shortlisted proposals will undergo a comprehensive due diligence and credit risk analysis.

Principles for ABSF Investment

Market Impact

- **Sustainable impact:** How the proposed investment will impact the SME lending market and associated capital markets?
- **Transparency:** Is the proponent willing to enhance data reporting and disclose certain aspects of the transaction to give potential investor a better visibility of the market?
- **Additionality/additivity:** Related to sustainable impact, how will the proposed investment help attract non-ABSF investments to the SME lending market?
- **Competition:** How would the proposed investment increase competition for SME lending generally?

Risk Management

- **Institutional quality:** Is the proponent a reputable institution and is its operating model and business strategy aligned with the longer term objectives of the ABSF?
- **Lending practices:** Can the proponent demonstrate good governance and how it models good practice in lending assessment, servicing and collections?
- **Social responsibility:** How does the proponent manage ESG risks? This includes unfair contract terms, AML/CTF and reputational risk
- **Transaction risk profile:** What is the risk profile of the structure of the transaction? And the credit quality of the underlying assets? Is the pool diversified?
- **Compliance:** Does the proposed transaction comply with the ABSF Act, ABSF Rules and ABSF Investment Mandate Directions? Can the proponent demonstrate its ability and willingness to comply with these as well as additional, transaction-specific reporting requirements over the life of the transaction?

5. CONCLUSION

The available documents on the ABSF are high level and more detailed, operational documents should be issued to provide clarification on the specifics of how the fund will operate. The AOFM has committed to provide next steps on the submission and assessment process. The role of the above listed ABSF Investment Principles in filtering proposals should also be explained, and there will be a discussion of the information that SME lenders are likely to be asked to provide as part of their submissions.

It is clear that carefully developed eligibility criteria will be critical to the effectiveness of the legislation. Moody's Analytics and our team of securitisation experts are engaged in working with our clients to understand the criteria

and how our solutions can contribute and help proponents in gathering the necessary information/data to participate in the assessment process.

6. REFERENCES

The Australian Government Treasury and Australian Office of Financial Management websites:

- <https://treasury.gov.au/consultation/c2018-t349315>
- <https://www.aofm.gov.au/absf>

Policy documents from the Australian Government:

- Exposure Draft Legislation
- Explanatory Memorandum
- Investment Mandate