

## GLOSSARY

**Assignment** A mode of transferring assets which involves the actual transfer of the title to the receivables. In relation to a mortgage, it would mean the transfer of a mortgage by the mortgagee (lender) to the mortgagor (borrower and occupier).

**Bankruptcy remoteness** A technique used for isolating assets or loans from the bankruptcy risk of the company selling them (originator). The originator finances its loans by transferring them to a special purpose vehicle (SPV) which issues securities backed by the loans. The transfer of the loans to the SPV is designed to be a “true sale”, which removes the loans from the originator’s balance sheet. This places the loans outside the originator’s bankruptcy estate in case it goes into bankruptcy. In addition, the SPV is established in such a way that it is independent from the originator.

**Capital adequacy** Regulations that require authorised deposit-taking institutions (ADIs), for example banks to maintain minimum amount of capital relative to the assets of the bank. Generally these requirements are set in accordance with the framework promoted by the Bank for International Settlements (BIS).

- Collateral** Assets are serving as security for a loan. The underlying security, mortgage, or asset are for the purposes of securitisation. In the case of a mortgage loan secured by collateral, if the borrower fails to make required payments, the lender has the right to seize and sell the collateral to recover the defaulted amount.
- Conduit** In securitisations, this means an entity (a trust or a company) formed to hold assets transferred by the originator on behalf of the investors. It issues securities backed by assets purchased by the SPV from the originator.
- Credit enhancement** Techniques used in a securitisation structure to improve the credit quality of a security or a bond so that it can obtain high rating, for example by providing a cash collateral or third party guarantee etc. Most securitisations use credit enhancements to allow their securities to obtain a triple-A (“AAA”) ratings.
- Credit risk** The risk that an issuer of debt securities or a borrower may default on its obligations.
- Delinquency** A condition of having failed to make one or more scheduled payment on a debt obligation. A borrower may be considered delinquent on its debt as soon as the due date of payment has passed.
- Equitable assignment** An assignment of receivables that does not complete the legal requirements for an assignment, for example a formal stamped instrument or a notice to borrowers etc. The common law recognises equitable assignment as creating an equity between the assignor and the assignee, though it cannot have any standing in relation to either the borrower or any third parties.
- Interest rate risk** The risk that a security’s value will change due to a change in interest rates. For example, a bond price drops as interest rates rise. For a depository institution, also called a funding risk, the risk that spreads income will suffer because of a change in interest rates.
- Interest rate swap** A contract between two parties to swap a fixed rate of interest for a floating rate of interest, or different bases for a floating rate of interest.
- Liquidity risk** The risk that arises from the difficulty of selling an asset in a timely manner. It can be thought of as the difference between the “true value” of the asset and the likely price, less commissions.
- Loan-to-valuation ratio (LTV)** The principal amount of a loan outstanding as a percentage of the valuation of the property forming the collateral for the loan.

- Mortgage** A creation of security interest, normally over real property, in order to secure a loan or debt obligation.
- Mortgage pool** A group of mortgages with similar class, interest rate, and maturity characteristics.
- Mortgage-backed securities (MBS)** This is a broad term which encompasses securities backed by a pool of mortgage loans. MBS are further classified into residential mortgage-backed securities and commercial mortgage-backed securities. Commercial mortgage-backed securities represent securities backed by mortgage loans for commercial properties such as multi-family dwelling, shops, restaurants, and showrooms.
- Mortgagee** The lender of a loan secured by a property.
- Mortgagor** The borrower of a loan secured by property.
- Off balance sheet** A debt or asset, which does not show up on the balance sheet of the entity that originated the asset or debt. In a securitisation transaction, if the transaction qualifies for a true sale, the assets transferred by the originator are off the balance sheet of the originator, and so is the amount received on account of such transfer.
- Originator** An institution which originates loans. In a securitisation transaction, the originator sells the loans to a trust or SPV, but typically retains the role as a servicer.
- Over-collateralisation** The provision of security for a loan or debt issue which is in the amount owing so as to offer protection to the lender or investor in the event of a fall in the collateral value.
- Pass through** It refers to a securitisation structure where the SPV makes payments on the securities to the investors, on the same periods, and subject to the same fluctuations, as are there in the underlying assets. That is to say, amount collected every month is passed through to investors, after deducting fees and expenses.
- Pay through** A form of debt security where the payments to the investors are paid through the SPV who does not strictly pay the investors only when the receivables are collected by it, but keeps paying on the stipulated dates irrespective of the collection dates.
- Prepayment** Payment of principal on a loan before its due date.
- Prepayment risk** The risk that borrowers prepay their mortgage loans. Mortgage loan prepayments tend to increase when interest rates fall and home-owners have the opportunity to refinance their loans at lower interest rates. In turn, prepayments return a substantial portion of invested principal to the MBS investors. Investors who receive a return principal may be forced to reinvest at lower yields. Hence, prepayment is viewed as a risk in securitisation.

**Securitisation** In a securitisation transaction, a company raises money by issuing securities that are backed by specific assets. In most cases, the underlying assets are loans such as mortgage loans, accounts receivables, or auto loans. The cash flow from the underlying assets usually is the source of funds for the issuer to make payments on the securities.

**Servicer** An entity that collects payments on securitised assets and that administers securitisation transaction. Administrative duties including processing payment to investors and transmitting periodic reports to investors and rating agencies. Often an originator of securitised assets acts as the servicer.

**Special purpose vehicle (SPV)** An entity established with the sole (special) purpose of purchasing assets and issuing securities backed by these assets to finance the purchase. Frequently, the SPV serves as a trust or a corporation. In relation to securitisation, it means the entity which would hold the legal rights over the assets transferred by the originator.

**True sale** In a securitisation transaction, the originator of assets transfers the assets to the SPV in a transaction designed to be a true sale. An example of a transaction that is not a true sale is a pledge of collateral to secure a debt. In securitisations, achieving a true sale is an important aspect of bankruptcy remoteness.

# INDEX

## A

- Accounts
  - administration and control of, 91
  - considerations of, 92–99
- Acknowledgement
  - of disclaimer, 169
  - by investor of the risks, 170
- Administrator, 198
  - appointment of, 191, 202
  - termination of, 191
- Agency costs of primary debt lending,
  - alleviation of, 226
- Amount borrowed, limit set to, 148
- Assignment, 106–114
  - programme, 5, 7
- Austraclear Ltd, 62
- Australian Competition and Consumer Act 2010 (Cth), 190
- Australian Financial Services Licence (AFSL), 172
  - requirements, 239
- Australian Prudential Regulation Authority (APRA), 74
  - prudential regulations, 252

## B

- Bank for International Settlements (BIS), 74
- Bank programme, 7, 44
- Bankruptcy-remote, 52, 54, 88
- Basel Accord, 74
- Borrowing company's business, proper and efficient conduct of, 148
- Breach of trust, 113

## C

- Capital adequacy, 26
  - guidelines, 63
- Capital and income unit holders, 53
- Capital for issuers, increase the costs of, 235
- Cash collaterals, 59, 211
- Charge over assets, 199
- Choses in action, 70
- Choses in possession, 70
- Civil liability, in relation to defective Information Memoranda, 159
- Civil penalty, 230

- Clauses, 178
    - independent legal advice about, 177
    - steps to notice existence and contents of, 178
  - “Clean” mortgagee rights, 230
  - “Clean Sale,” guidelines for achieving, 226–227
  - Client’s Declaration of Understanding of Risk, 170
  - Collateralised borrowing, 103
  - Collection manager, 56
  - Commingling of assets, 210
  - Company arrangement, deed
    - execution of, 191
  - Company, winding up, 191
  - Competition Principles Agreement 1995, 10
  - Compliance and cost issues, 244–245
  - Comprehensive disclosure
    - requirements, relief from, 240
  - Conduit programmes, 9, 44–45
  - Consent to transfers, reasonable opportunity to refuse, 277
  - Consequences of assignment, 178
  - Content of prospectus, 151
  - Contest of priorities, 72
  - Contractarian theory, 270
  - “Control approach,” 93
  - Convene meetings of the originating bank’s creditors, 192
  - Convening period, 192
  - Corporate governance, 209
  - Corporate trustee-issuers, role of directors, 208–209
  - Corporations Act 2001 (Cth), 48, 129, 239, 248
    - Section 18, 168
    - Sections 9 and 92 of, 143
    - separate regime in, 276
  - Cost-benefit analysis, 34
  - Covenants, 148
  - Credit contract, terms and cost of, 228
  - Credit enhancement, 56–59
    - techniques, 253
  - Credit provider, 115, 118
    - commissions to be paid by, 228
    - easily legible, notice given by, 227
    - failure by, 117
    - IMP, 228
    - in RMBS programme, 118–121
    - trustee becomes, 228
  - Credit risk, 24
  - Criminal penalty, 230
  - Crystallises, 140
  - Custodian, 56
- D**
- “Dealing” in financial products, 174
  - Debentures, 129, 238
  - Debts
    - instrument, 141
    - issues, 48
    - limitations on, 207–208
    - originating bank assets, secured creditors, 193
  - Deceit/negligent misrepresentation, 168
  - Deceptive statements, 164–167
  - “Decision period,” enforce the charge during, 192
  - Defence of reasonable reliance, 166–167
  - Defences for misleading, 164–167
  - Definition, 144
    - of debenture, 144
  - Delayed payment risk, 24
  - Disclaimers, use of, 168–171
  - Disclosed agent, 56
  - Disclosure documents, 150, 151, 240
    - with ASIC, 153
    - content of, 239
    - omission from, 155
    - relevant to RMBSs, 149–172
  - Disclosure obligations, 246–249
  - Disclosure requirements, 152

Due care and diligence, failure to show, 132

“Due diligence,” 248  
defence, 165–167

#### Duty

to exercise reasonable skill, 180  
not to discrimination, 132  
not to engage in conflicts of interest/profit from position as trustee, 132–133  
to refrain from fraud/deliberate wrongdoing, 132

#### E

Enforcement action, freeze assets and suspend, 192

Enforcement of security trust deed, 257–258

Equitable assignment, 53, 71, 72, 106, 232

transferred to SPV by, 224

Equitable mortgage, 71

Equity instrument, 141

Events of default, 140

Exceptions, 152

Excluded offers, 240–241

Exclusion clauses, 257

#### F

Financial Accounting Standards Board (FASB)

statement No. 13, 94

statement No. 77, 95

statement No. 125, 96–97

statement No. 140, 97–99

Financial arrangement, 99

Financial components approach, 96

Financial hardship, 237

Financial innovation, 1

Financial products, 173  
advice, 174, 272

Financial risks, 182, 251–258

Financial security of issuers, protection of, 252

Financial services, 173  
relation to, 160

Financial Services Reform Act 2001 (Cth), 239

Financial sophistication of the target group, 163

Fine print in mortgage documents, 233

First Australian National Mortgage Acceptance Corporation (FANMAC), 3

First priority fixed charges, 211

Floating charge, 140  
registered with ASIC, 139

Foreclosure of collateral, 256

Fund manager, 44, 55–56

make other changes to the trust deed, 134

Fund raising activities, 144

Fund raising provisions for issue of RMBs, 149–151

#### G

General disclosure test, 151

Guarantor risk, 25

Guidelines for capital adequacy, 73–83

#### H

Hardship risk, 236–237

Hedging agreements, 181–183

Higher investment rating, 226

Home visits, 237

#### I

Incentives for stakeholders, 28–31

Increasing investor confidence, 239

Independent custodian, 245

- Independent mortgage provider (IMP), 44
  - Informational efficiency, 228
  - Information asymmetry, 32, 246
  - Information Memoranda, 150, 272
    - liability for misstatements and omissions in, 155
  - Inquiries, reasonable in circumstances, 165
  - Insolvency
    - and bondholders, 190–193
    - considerations of, 189–212
    - risk, 251–258
    - of SPV in capacity of issuer, 200–206
  - Insolvency Act 1986 (UK), 204
  - Insolvency-remote, 197
    - of the SPV, 225
  - Insolvency risk-remote legal structure, developing an, 252
  - Institutional and professional investors, 240
  - Insurance Contract Act 1984 (Cth), 257
  - Intent of the parties, 91–92, 102
  - Interest rate
    - futures and options, 182
    - risk, 254
  - Interest rate swap
    - agreement, 257
    - contracts, 182
  - Investment Company Act of 1940, 245
  - Investment of trust funds, 134
  - Investment powers of trustee, 136–137
  - Investment tailored to investor preferences, 239
  - Investors, 154
    - minimising risk to, 200
    - from prepayments, risks to, 235
  - Irrevocability, 92
  - Isolation of mortgages in “insolvency-remote” entity, 225
  - Issuance of securities, 61–62
  - Issuer insolvency, risk of, 252
  - Issuer’s exposure to third-party insolvency, protection of, 252
- J**
- Judgment, 133
  - Judicial interpretation, 99–106
- K**
- Key difference, 47
  - Key information requirements, 250
  - Key rights to borrowers, 116
- L**
- Legal assignment, 53, 106
  - Legal owner of the mortgages, 193–194
  - Legal risk, 24
  - Lender
    - and borrowers, set-off issues between, 234
    - record, 54
    - right to exercise its power of sale, 223
    - right to receive principal and interest repayments from the borrower, 223
  - Liability, professional indemnity insurance to cover, 237
  - Licensed Dealer Exemption, 152
  - Licensing of participants, 241–242
  - Lien, 138
  - Limited recourse of creditors, 211
  - Liquidating issuer’s assets, debts paid from, 211
  - Liquidators, 198
  - Liquidity risk, 25
  - Loan contract, 180
  - Lowering financing costs for originators, 219

**M**

Macquarie Bank  
 PUMA Fund, 138  
 PUMA programme, 47  
 Macroeconomic implications, 273  
 Managed investment schemes,  
 147, 244–251  
 Management deed, 55  
 Master Trust, 52  
 Materiality, 156  
 Materially adverse, 156  
 Material new circumstance, 159  
 Material omission, 157  
 Minimising risks, 252–255  
 Mislead and deceptive, 161  
 conduct, 160  
 statement in either the disclosure  
 document, 155  
 Misstatements, people who are  
 potentially liable for, 159  
 Mitigation of risks, 236–237  
 Monetary advances, 50–52  
 Monetary ceiling, lack of, 234  
 Moral hazard, 32, 109, 270  
 problem, 232  
 risk of, 181  
 Moral risks retained by the originating  
 bank, 227  
 Moratorium, 192  
 Mortgage  
 insurance, 57–58, 236  
 prepayment, 235–236  
 as security, 69–71  
 transfer of a lender's right to receive  
 principal and interest  
 repayments on, 225  
 Mortgage-backed securities (MBSs), 22  
 issue of, 129–184  
 Mortgage debentures, section  
 283BH, 146  
 Mortgage defaults, risks and  
 costs of, 237

Mortgagee rights to SPV, regulation  
 for facilitating the transfer of,  
 225–230  
 Mortgage insurance payout, lender's  
 right to, 223  
 Mortgage loan  
 grounds of hardship, variance on, 257  
 tradable securities, transformation  
 of, 238  
 Mortgage origination, 48, 51, 69–84  
 process of, 48–49, 218–223  
 Mortgage pool, 23  
 composition of, 190  
 quality of, 253  
 Multiple classes of debt, 210

**N**

National Competition Policy  
 reforms, 34  
 National Credit Code (NCC),  
 49, 58, 115–123, 229,  
 234–237, 254, 274  
 disclosure requirements, 227–228  
 Nature of documentation, 91  
 Nature of the 'recourse' status, 89–90  
 New regulatory framework, 273–276  
 Nominated credit provider, 230  
 Notice of assignment, 232–234  
 Notice of the borrower, 177–181, 277  
 Notice to third party, 92

**O**

Objects clause, 207  
 Obligations, 56  
 Off-balance sheet  
 exposure, 63–64  
 financing for the originator, 226  
*vs.* on-balance sheet financing, 26  
 treatment of assets, 224  
 Optimal regulatory framework, 35

Originating bank, 228  
 Originating mortgagee's rights, 106–114  
 Originator, 49  
   and borrower under property  
     legislation, rights and  
     obligations of, 219–220  
   insolvency, 193–197  
   receive payments from borrowers, 229  
   as servicer, 49  
 Over-collateralisation, 254

## P

Pass-through, 23  
   *vs.* “pay-through” structures, 45–48  
 Payments in advance, 121–123  
 Pay-through, 23  
 Periodic payment, 23  
 Personal liability, 199  
 “Plain English” initiative, 251  
 Power of sale, security properties, 149  
 Power to reopen unjust credit  
   contracts, 237  
 Pre-contractual disclosure, 115  
 Pre-contractual statement setting, 227  
 Predominant-characteristic paradigm, 93  
 Prepayment risk, 24  
 Pricing mechanism, 90–91  
 Priority contests between  
   mortgagees, 220  
 Priority rights, 257–258  
 Problem of notice, 109–112  
 Product Disclosure Statements to  
   investors, 148  
 Professional investors, 152–153  
 Property Law Act 1974 (Qld), 107  
 Property legislation, 225  
 Proposed assignments, borrowers  
   notice of, 277  
 Prospectuses, 150  
 Prudential standard  
   APS 112 capital adequacy, 78

  APS 113, 78  
   APS 120, 76  
 Prudential supervision requirements, 73  
 Public benefit test, 10, 19, 34  
 Public good effects, 32  
 “Public” investor market, 238

## Q

Qualified Special Purpose Entity  
 (QSPE), 96

## R

Reasonable expectation  
   disclosed omitted material, 164  
   test, 248  
 Recommendations, 276–278  
 Reduction  
   in cost of funds for originators and  
     issuers, 224  
   in regulatory capital, 219  
 Registered mortgage, 71–73  
 Regular account statements and  
   notices, 115  
 Regulation of industry participants,  
   172–176  
 Regulation of securitisation market,  
   32–36  
 Regulation of trustees, 130–141  
 Reimbursed for legitimate expenses, 138  
 Related insurance contracts, 199  
 Representations and warranties, 253  
 Residential mortgage-backed securities  
   (RMBSs), 22  
   achieving a high credit rating for, 239  
   creation of senior/subordinated  
     tranches of, 253  
   as debentures, 143–147  
   issuance of, 238–251  
   panel of independent experts on, 278  
   risks in investment, 255–257

- risk-weightings applied to highly rated, 220
  - structure of, 141–149
  - Residential mortgages, 49–50
  - Responsible entity, 147, 244
  - Retail investors, 240
  - Retention of servicing revenue, 219
  - Right in equity to indemnify, 138
  - Rights for collection of surpluses, 90
  - Rights transferred to the SPV, 223
  - Right to exercise its power of sale, 220
  - Right to repurchase, 90
  - Risk-based capital guidelines, 74
  - Risks and rewards, 93
  - “Risk weighted assets,” 76
  - Risk-weighting of RMBS, 76–80, 220–222
    - in overseas jurisdictions, 81–83
- S**
- Secured borrowing, 92
  - Secured creditors, 139
  - Secured financing arrangement, 230
  - Securities Act of 1933, 250
  - Securities and Exchange Commission of the United States, 245
  - Securities Exchange Act of 1934, 250
  - Securities of less than \$500,000, issue of, 154
  - Securitisation, 2, 20–22, 76
    - acquisition of good quality mortgage loans for, 218
  - Security trust deed, 258
  - Security trustee, 139–141, 201
    - duty to exercise reasonable diligence, 148
    - enter into contracts, 141
    - right of indemnity, 140
    - to sell charged assets, 190
  - “Self-dealing” exemption, 242
  - Senior and subordinated bonds, 235
  - Senior notes, 58
  - Senior/subordinated structure, 257
  - Separate disclosure regime, 251
  - Separate disclosure standards, 249–251
  - Separateness covenants, 209–210
  - Servicer, 21
    - performance risk, 25
  - Set off claims, 111
  - Silence
    - on issue of securities, 162
    - in respect of the contract and its clauses, 179
  - Simple assignment clause, 177
  - Slow payment risk, 24
  - Sold to retail investors, 154
  - Sophisticated investors, 152, 238, 243
    - exception, 152
    - institutional, 273
  - Source of payment, 224
  - Special purpose vehicle (SPV), 6, 52, 114
    - acts in good faith, 195
    - equitable title to the mortgages, acquires an, 224
    - insolvency-remote, making, 224
    - limits on powers and objects of, 207
    - transfer of mortgages to, 230–238
    - trust structure, 225–226
    - rights transferred to, 6
  - Special resolution of bondholders, 134
  - Spotter’s fee, 49
  - SPV-assignee
    - originator remains the legal owner and holds the legal title on trust for, 244
  - Stakeholders, risk minimisation for, 206–211
  - Standard of disclosure in an information memorandum, 247
  - Statutory Instruments Act 1992 (Qld), 10, 278
  - Structural credit enhancements, 58–59

Structuring mortgage securitisation programme, 43–48  
 Sub-funds, 226  
 Subordinated notes, 58  
 Subordination  
   and insolvency, 206  
   loan facilities, 196  
 Substance over form, 106  
 Substitution of mortgages, 50  
 Suing on the debt, 112

**T**

Tax liability of the issuer, 210–211  
 Tax neutral, 211  
 Timely disclosure requirements, 277  
 Torrens system, 71  
   of land holding, 219  
 Transferring lender's rights, 53–55  
 True sale, 54, 80, 88–92, 230, 231, 271  
   mortgages, 224  
 True securitisation, 230  
 Trust  
   assets, 139–140  
   deed, 131, 148–149  
   deed, obliged to obey the terms, 133  
   property, 138  
 Trustee  
   to act gratuitously, 132  
   appointment of, 130  
   *vs.* bondholders, 136–139  
   duty of care and diligence, 131–132  
   indemnity from assets of trust, 198  
   retirement and replacement of, 130  
   right of indemnity from trust  
     property, 137–139  
   rights, obligations and duties,  
     131–133

Trustee-issuer, 118, 141  
   insolvency, 197–206  
 Trust fund, appointment of a receiver  
   to, 190  
 Trust liabilities, 137  
   management of, 134  
 Typical securitisation programme,  
   redemption in, 200–202

**U**

Uncommercial transactions, 194, 195  
 Unconscionable, establishment  
   charge, 235  
 Unfair loan agreements, protection  
   against enforcement of, 117  
 Unfair preferences, 194, 196, 203, 205  
 Unjust loan contracts, 230, 237  
 Unregistered mortgage, 73  
 Unsecured deposit note, section  
   283BH, 146  
 Unsolicited invitation, 237  
 US Securities and Exchange  
   Commission (SEC), 250

**V**

Voidable transactions, 194  
   affect the originating bank's  
     property, 192  
 Voluntary administration, 191

**W**

Warehouse funds, 226  
 Warehouse trust fund, 52, 53  
 Warranties, 50  
 Wholesale financial services market, 241