

# Commercial Law Aspects of Residential Mortgage Securitisation in Australia

Pelma Rajapakse • Shanuka Senarath

Commercial Law  
Aspects of Residential  
Mortgage  
Securitisation  
in Australia

palgrave  
macmillan

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ISBN 978-3-030-00604-4      ISBN 978-3-030-00605-1 (eBook)  
<https://doi.org/10.1007/978-3-030-00605-1>

Library of Congress Control Number: 2018968613

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This Palgrave Macmillan imprint is published by the registered company Springer Nature Switzerland AG.

The registered company address is: Gewerbestrasse 11, 6330 Cham, Switzerland

## FOREWORD

In 1998, as a young academic, I wrote the first article warning of the macro-economic risks of securitisation transactions. During the late 1990s, the volume of issuance of asset-backed securities backed by all types of receivables and cash flows was increasing exponentially, year after year. There was also very little regulation or oversight of the transactions' structure, the credit quality of the underlying receivables, the value of the underlying collateral, as well as considerable uncertainty in governing law. Without much oversight, the financial services industry, which was making a great deal of money from these transactions, extolled the benefits of securitisation to both issuers and investors. Likening it to alchemy, securitisation enthusiasts failed to consider the possibility that the house of cards the industry was built on could ever come tumbling down. And tumble it did. The global financial crisis of 2007 saw the failure of financial institutions, extraordinary defaults by issuers, and loss contagion across the globe. Securitisation was "singled out for censure" as a significant contributor to the collapse of the financial markets.

Fast-forward ten years: the global economy has recovered and securitisation has had a resurgence to the point that it is currently a *ten-trillion-dollar* industry, begging the question of whether we have learnt anything from the failures and losses in the securitisation markets during the recent financial crisis. Which is why *Commercial Law Aspects of Residential Mortgage Securitisation in Australia* by Dr Pelma Rajapakse and Dr Shanuka Senarath is so important and so timely. Residential mortgage-backed securities, or RMBSs, are bonds or notes that are backed by residential mortgages or residential real estate loans. When the market for

these securities falters or fails, entire neighbourhoods and even entire cities can lose billions of dollars in value. This loss of value has a direct impact on not only institutional market investors but also homeowners and families.

In their examination of the securitisation of residential mortgage loans in Australia, Drs Rajapakse and Senarath do a masterful job of elucidating the complexity of these transactions. In their methodical exploration of areas of regulatory gaps and careful identification of securitisation's negative externalities, they provide an important critical analysis. *Commercial Law Aspects of Residential Mortgage Securitisation in Australia* is an important reading for those who care about well-regulated and well-functioning public financial markets and recognise the contagion risks of market failure in the absence of oversight.

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## PREFACE

In a residential mortgage-backed security (RMBS) programme, a bank or other financial institution sells its rights in a pool of home loans to a special purpose vehicle (SPV), which pays for the asset pool by issuing fixed or floating rate bonds in the financial markets to institutional investors. The SPV finances the interest and principal payments under these bonds from the pooled home loan repayments. The SPV is a “special purpose” vehicle in the sense that it is established especially, and solely, for the purpose of acquiring the asset pool and issuing bonds against it.

In practice in Australia, the SPV itself is invariably structured as a trust, which holds the asset pool on behalf of the bondholders. Frequently, but not always in Australia, the income and security features of the asset pool are effectively split, so that the SPV retains the rights to the income from the asset pool but grants a charge or charges over the property in the asset pool in favour of a separate “security trustee”, who holds these on behalf of the bondholders. In selling the asset pool to the SPV, the bank or financial institution removes those assets—subject to prudential regulator’s approval—from its balance sheet for prudential regulation purposes. This has the effect of substantially reducing the bank’s or institution’s operating costs. For regulatory and tax purposes, it is important that the SPV is seen to be entirely independent of the originating bank or institution; that the sale to the SPV is seen as a “clean sale”; and the SPV is “insolvency-remote”, in the sense that the asset pool cannot be put at risk by the insolvency of the SPV or the originating institution.

There is a dearth of both academic and practical literature on the legal and regulatory issues surrounding mortgage-backed securitisation programmes in Australia, as compared with overseas jurisdictions, such as the United States and the United Kingdom. Moreover, the descriptions of RMBS programmes overseas do not always accord with the way in which RMBS programmes are structured in Australia in practice. This book seeks to redress that imbalance.

To date, no comprehensive textbook or scholarly research book on mortgage securitisation law has been published in Australia. This book will make an excellent source of reference for both undergraduate and post-graduate students of business and finance law, academics, and legal practitioners in these areas. It is designed to provide the reader a comprehensive reference source on RMBS programmes, which can also be used by post-graduate students, academics, and professionals as a basis for further research on this topic.

Writing a monograph is a long venture if it was not for the encouragement, guidance, and support of many people. I am very much grateful to Dr Shanuka Senarath, who is a co-author for this book. Shanuka's personal willingness and commitment in editing the chapters have supported me for successful completion of this book project.

This book provides the most updated information on the law and the current practice of residential mortgage securitisation in Australia. I greatly acknowledge the guidance and support of my research supervisors, Dr Richard Copp, Dr Eduardo Roca of the Department of Accounting, Finance and Economics, Griffith University and Professor Justin Malbon of the School of Law, Monash University, Victoria.

I am grateful to Professor Lois R Lupica of the University of Maine School of Law, Portland, Maine, USA, for writing an explicit foreword for this book. Special thanks are due to Professor Fabrizio Carmignani, Head of the Department; Dr Jennifer Dickfos and Professor Brett Freudenberg, the Discipline Heads of the Department of Accounting Finance and Economics and Professor Don Anton, Director of the Law Futures Centre for their encouragement and support during the writing stages of this monograph. I gratefully acknowledge the resources and financial support provided by the Department of Accounting, Finance and Economics, and the Law Futures Centre of the Griffith Law School, at Griffith University.

The views and opinions expressed in the book belong solely to the authors, and any errors of omission that remain are the authors' responsibility. The law and practice are stated as at 31 October 2018.

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# ACRONYMS

AASB	Australian Accounting Standards Board
ACCC	Australian Competition and Consumer Commission
ACL	Australian Consumer Law
ADI	Authorised Deposit-taking Institutions
AFSL	Australian Financial Services Licence
APRA	Australian Prudential Regulation Authority
APS	APRA Prudential Standards
ASC	Australian Securities Commission
ASF	Australian Securitisation Forum
ASIC	Australian Securities and Investments Commission
ASX	Australian Stock Exchange
BIS	Bank for International Settlements
CCA	Competition and Consumer Act
CLERP	Corporate Law Economic Reform Program
FANMAC	First Australian National Mortgage Acceptance Corporation
FSI	Financial System Inquiry
FSRA	Financial Services Reform Act
GIC	Guaranteed Investment Certificate
GST	Goods and Services Tax
IMP	Independent Mortgage Provider
ISC	Insurance and Superannuation Commission
MBSs	Mortgage-Backed Securities
MIS	Managed Investment Scheme
MMSs	MGICA Mortgage Securities
RMBSs	Residential Mortgage-Backed Securities
SPV	Special Purpose Vehicle
TPA	Trade Practices Act

# LIST OF LEGISLATION

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Competition Policy Reform Act 1995 (Cth)  
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