Perpetual Corporate Trust

# Emerging opportunities:

## An in-depth assessment of Whole Loan Sales in Australia

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# Overview

Diversity of funding has always been important to the successful and sustainable funding of Australian issuers. In the Australian market, issuers have tended to follow a traditional growth trajectory, starting with equity financing, moving onto warehouse funding, and ultimately engaging in RMBS term deals and for larger ADIs Covered Bonds.

Perpetual Corporate Trust's 2023 report "The non-bank sector in Australia and New Zealand: past, present and future" identified continued access to funding as one of the key drivers of success for Australian issuers. The shifting economic cycle of 2023 – and the impact this has on consumers – has also highlighted the imperative for funding innovation.

Lower wholesale funding costs can attract new players to the market, providing consumers with more choices. Given the ever-changing economic conditions and funding cycles, market adaptation and innovation are essential to safeguard consumer's access to credit. Moreover, it's worth noting that innovative funding practices can foster the emergence of innovative lenders, resulting in a more tailored and beneficial product landscape for borrowers.

In international markets Whole Loan Sale (WLS) and other alternative funding opportunities are frequently used to diversify funding, however in Australia these options are at nascent levels. How much longer this remains the case, requires further investigation.

The research "Emerging opportunities: An in-depth assessment of Whole Loan Sales in Australia" aligned with PCT's vision to become the most trusted partner to the banking and financial services industry, seeks to address several critical objectives, including:

- the potential for a local WLS marketplace;
- the potential benefits for banks, non-banks and investors; and
- increasing the efficiency and effectiveness of funding in Australia.

**Richard McCarthy**
Chief Executive
Perpetual Corporate Trust

# A deeper dive into Australian RMBS

Special feature: Perpetual Intelligence insights

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# RMBS arrears performance against the current cycle of interest rate hikes

Perpetual Digital, PCT's innovation company, leverages 25 plus years of expertise and experience in securitisation, data solutions and analytics to help clients, and the broader ecosystem, to be more effective, efficient, scalable and economical, while managing ever-increasing cyber security risks and maintaining compliance.

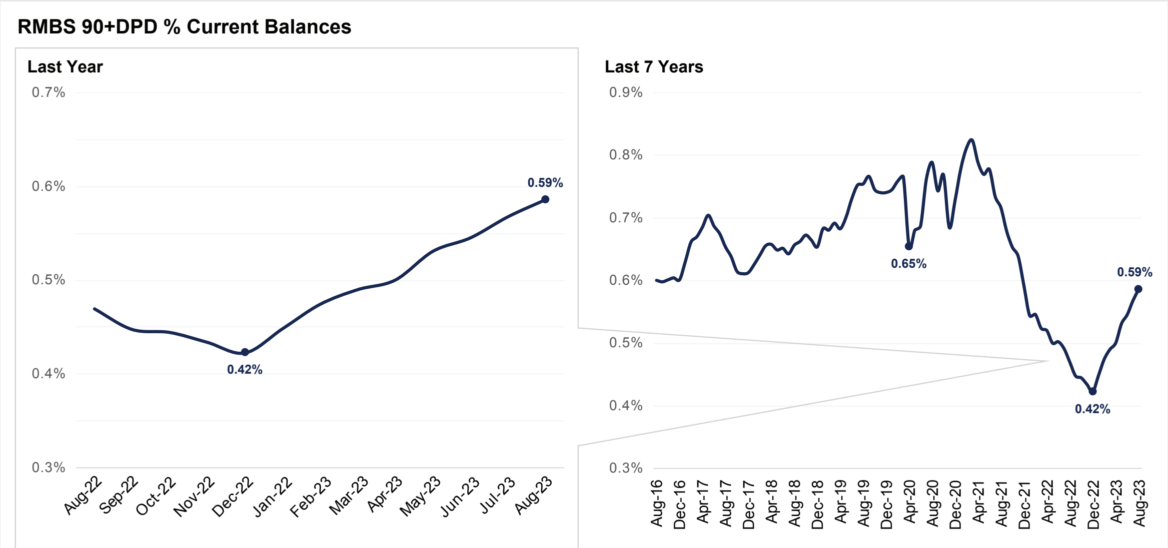
Perpetual Corporate Trust has been a leading provider of Asset-Backed Securities (ABS) information since the launch of our reporting service in 1997. ABSPerpetual is the Australian Data Warehouse, which covers over 40 issuers and more than 300 trusts. It provides a unique point of reference for domestic and global investors and intermediaries who seek timely, accurate and comprehensive transaction and collateral information.

With the recent surge in the RBA cash rate, which has seen the Reserve Bank raise interest rates 12 times since May 2022, there has been considerable media attention on borrowers' ability to adjust to higher mortgage repayments and the impending 'mortgage cliff' as borrowers roll off low fixed rate mortgages. Despite the negative sentiment, our analysis of the RMBS data set powered by Perpetual Intelligence shows that arrears performance to date has been better than perhaps most had expected.

Total arrears that are 90 days past due has lifted considerably throughout 2023, with the total RMBS 90+DPD arrears as a % of current balances growing by 17 basis points since December 2022. Whilst this is a significant lift at face value, it has to be taken into context that this rise has come from an extremely low base – a rate that was 20 basis points lower than any time in the past seven years.

When viewed with a long-term horizon, this somewhat concerning rise in arrears that occurred in 2023 shows that RMBS 90+DPD arrears performance is currently still tracking below pre-COVID 2019 levels.

### RMBS 90+DPD Delinquencies

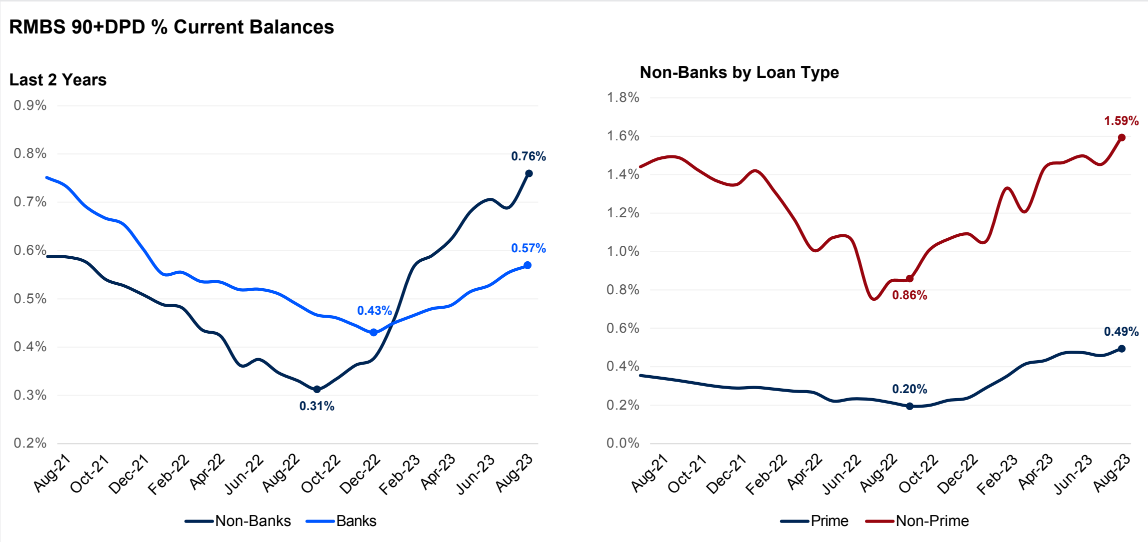



A drill down into the arrears performance of banks vs non-banks shows that the rise in 90+DPD arrears has been more significant for the non-banks where the rate has lifted by 45 basis points compared to the banks rising by only 14 basis points. For the non-banks, the major driver has been a lift in the non-prime loans representing just under a quarter of the total non-bank loans balances. Prime Loans have also increased but are tracking at levels similar to the banks, with the total RMBS 90+DPD arrears as a % of current balances growing by 17 basis points since December 2022.

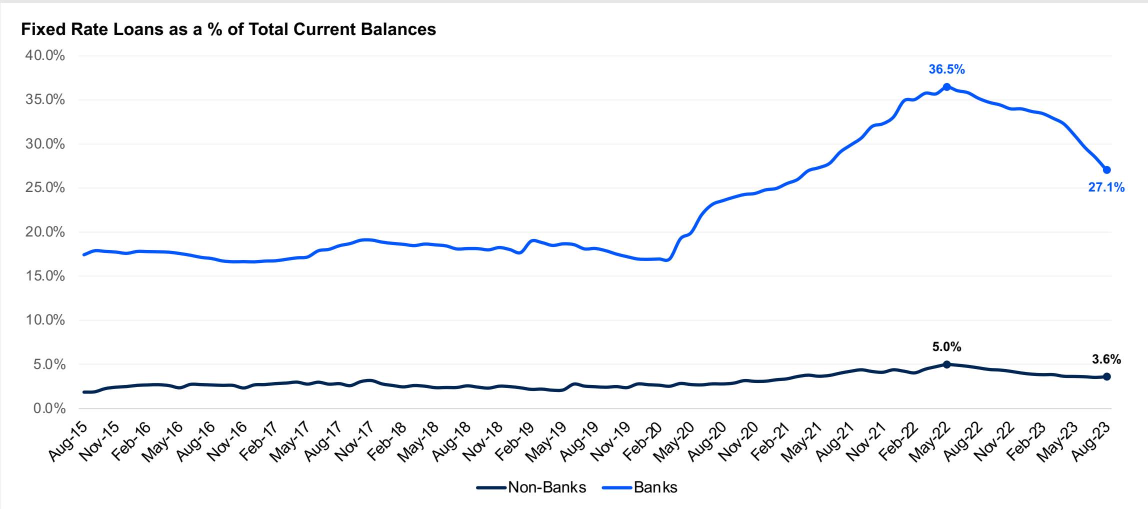
A possible explanation for the more significant rise in arrears for the non-banks is due to the majority of non-banks loans being on a variable rate (currently less than 4% of total loans are fixed rate compared to the banks where the figure is 27%), more borrowers have been immediately exposed to the impact of the rate rises and the resulting mortgage stress whereas those on the low fixed rate loans have only more recently started to experience.

Again, it is important to highlight that the rise in arrears for the non-banks is coming off a record low base of just 20 basis points.

### RMBS 90+DPD Delinquencies



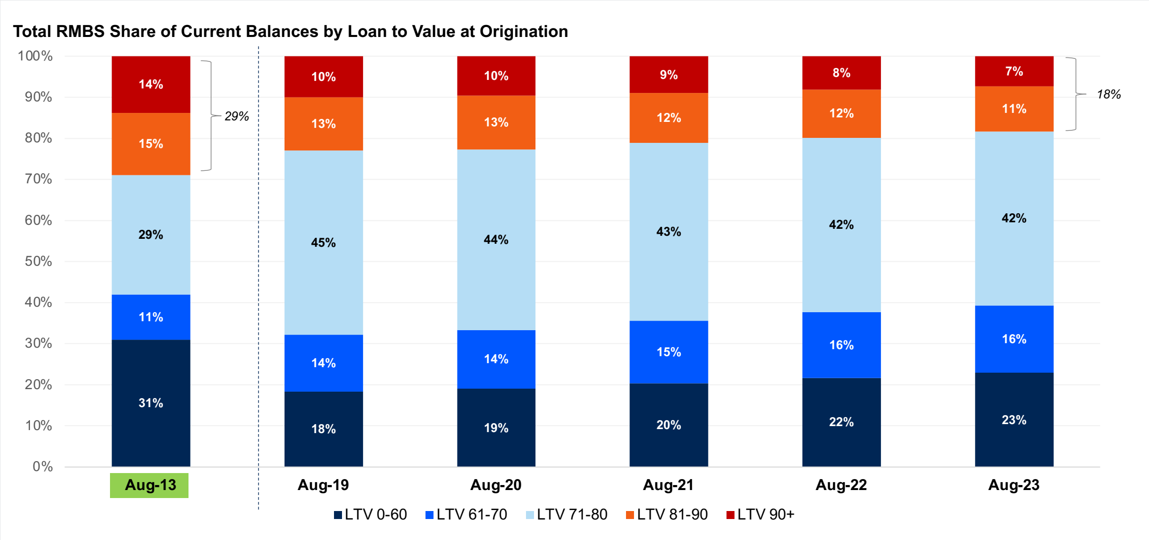

### RMBS Fixed Rate Mortgage Loans



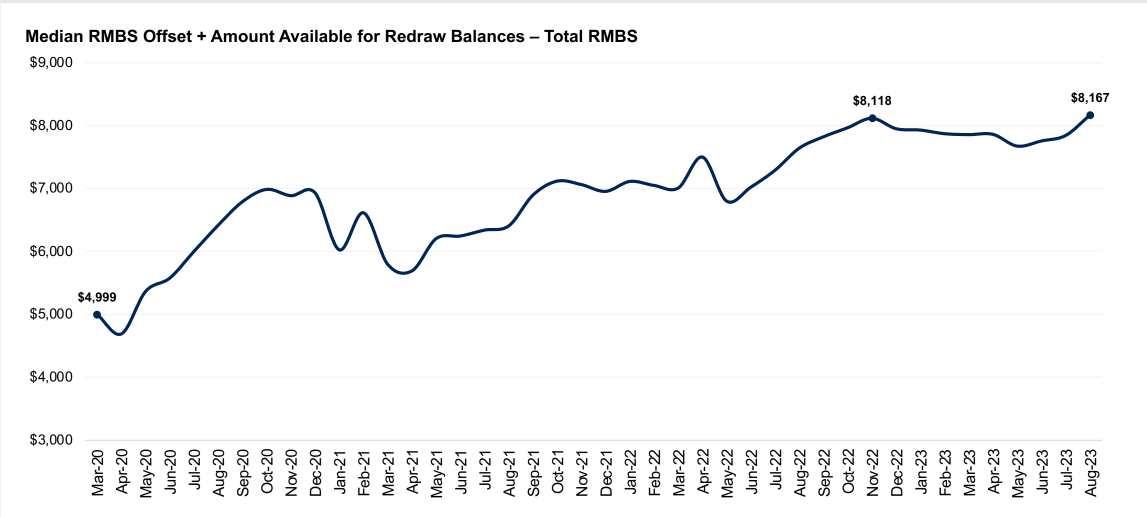

In addition to looking at recent movements in arrears rates, an assessment of the mortgage sector's ability to manage through the rapid rise in interest rates should also look at other key loan portfolio metrics – such as Loan to Value (LTV) ratios and offset and redraw amounts. The following two charts highlight that the RMBS mortgage industry is coming from a position of strength where;

1. High LTV ratios (i.e. >80%) currently represent only 18% of total loans. This figure is a significant reduction compared to ten years ago, when loans with an LTV >80% represented 29% of total loans. (Note: these ratios are based on when the loan was originated and do not incorporate house price growth, which will have further strengthened the equity position of borrowers over time.)
2. Median offset and redraw amounts are high, having lifted throughout COVID and whilst no longer growing, have remained high and are well above pre COVID levels.

## Share of RMBS Balances by Loan to Value Ratio




## RMBS Offset Balances and Redraws

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All graphs source: Perpetual Intelligence Insights from the Australian RMBS Private and Public Data, as at August 2023

# Contents



# Executive summary

The report delves into the landscape of Whole Loan Sales within the Australian market, offering a comprehensive examination of this alternative funding avenue. Notably, Australia contrasts with international counterparts, as Whole Loan Sales remain relatively scarce. Unlike the Global Financial Crisis, which spurred growth in other regions, Australia's market has not experienced a similar surge in this financing method. Nevertheless, there is a growing intrigue around Whole Loan Sales among Australian originators, who view it as a means to optimize their balance sheets and diversify funding sources.

Despite this curiosity, active participation remains limited, often initiated by investor interest rather than the proactive pursuit of originators. This restrained engagement in Whole Loan Sales stems from a blend of perceived complexities, uncertainties regarding demand, and the convenience of existing funding mechanisms. However, those who have ventured into this terrain have noted a range of advantages, such as cost savings, access to high-quality assets, and diversified funding options.

Navigating Whole Loan Sales in Australia requires careful consideration of practical aspects, particularly in terms of data management, reporting, and establishing a robust servicing regime. Pricing and valuation also present challenges, with divergent opinions on benchmarking and suitability across economic cycles. Yet, there is an underlying optimism that, over time, Whole Loan Sales could attract new funding sources, benefiting both originators and investors in the Australian mortgage market. In essence, while the market remains in its infancy, there is growing recognition of the potential for Whole Loan Sales to reshape the funding landscape in Australia.

# Methodology

Both qualitative and quantitative research was undertaken for this report. A series of 17 conversations with a range of industry participants were conducted to gauge their perception of the potential for Whole Loan Sales. This was complemented by an online survey to test the theories that emerged from the in-depth discussions.

The individuals interviewed were in two primary categories, originators and financiers. The originators were local and predominantly RMBS issuers. The financiers were mainly global banks or investment managers, providing warehouse facilities and/ or finance. This group has been classified as Global Financiers for the report.

The report covers a wide spectrum of issues surrounding Whole Loan Sales, including:

- How are they defined?
- In what circumstances do they make sense?
- What are the benefits and barriers?
- What are some of the practical considerations?
- Who are the natural buyers?
- Will Whole Loan Sales be a growing, sustainable feature of the Australian market?

# A matter of definition

When introducing new concepts or possibilities, it is beneficial to derive a common definition of what is being proposed. Simple is often best, and despite a wide variation in the specific definition participants used, the single fundamental and common characteristic for a Whole Loan Sale was that it occurs when a loan portfolio is sold to a funder.

> "To me, it would be when you're selling a loan portfolio or buying a loan portfolio, so it will be a portfolio of X amount of loans, totalling X amount of dollars, and you are buying it or you're selling it."
>
> **Originator**

The nuances in definition emerge when referencing specific details, such as who does the servicing, whether the Whole Loan Sale is a one-off or whether there will be an ongoing arrangement between the buyer and the seller.

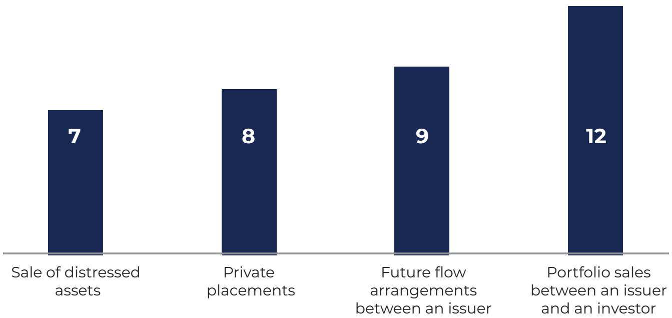
Some naturally include portfolio sales, including sales of distressed assets, in the category of Whole Loan Sales whereas others believe it is a bilateral arrangement between a buyer and a seller.

It can be argued it's beneficial to keep the definition fluid, given that innovation in the market is always ongoing.

> "I think there are different possible formats. We've done a format in which we've sold loans directly onto the balance sheet of the buyer but equally, you could imagine whole loans being wrapped up in some sort of MIS, some sort of managed fund or something as well for a different type of buyer. So it's not as if we've really explored the breadth of what could be done in these sorts of transactions."
>
> **Originator**

The qualitative research highlighted a diversity of opinions when thinking about Whole Loan Sales. The chart below shows several formats are readily included in the definition, yet when speaking with participants, there were strong views that private placements should not be included in the definition because the risk stays with the originator as the assets are not transferred.

**What do you consider to be examples of Whole Loan Sale transactions?**




Other variations to the definition are addressed in the Benefits and Barriers sections of the report.

The low incidence of Whole Loan Sales in the Australian market suggests no overwhelming need for originators and/ or investors to participate in Whole Loan Sales. This is in contrast to Europe and the US, where Whole Loan Sales have been a feature of the market for many years.

It was suggested that the growth in Whole Loan Sales in overseas markets was prompted by the GFC and the sudden incidence of distressed portfolios needing a new home. While there have been instances of distressed portfolio sales in Australia, it has been more common for originators to consider a portfolio sale when they have a portfolio that is no longer aligned with their strategy.

> "What we have done previously, on a bilateral basis, is we have sold a portfolio of loans to another bank. It was a segment of loans that we were exiting strategically and there was another bank that was happy to buy them. We continued to service those loans and effectively pass through the collections to the new owner of those loans."
>
> **Originator**

As an alternative form of funding, originators have used Whole Loan Sales to free up capacity in their balance sheet. There were other reasons participants gave for considering Whole Loan Sales, although it was not typical for originators to have participated in the types of transactions they described.

> "It's just a strategic decision on how we allocate the balance sheet and where I think our strengths are, writing new loans, a series of loans to keep people happy, and whereas the constraint was around the balance sheet, so we decided to free up some capacity for new customers. We continue to service those loans well for existing customers, but someone else can fund them."
>
> **Originator**

Primarily, the inclination to engage in a Whole Loan Sale stemmed from the necessity to seek alternative funding sources. The use of forward flow agreements ensures the transaction delivers ongoing value to both the buyer and the seller and helps to offset the effort they feel is needed to set up this type of arrangement in the first instance.

> "First of all, it's simply a funding tool. So, as a non-bank, primarily the funding is done through wholesale markets, and there's at certain times limited capacity in those markets or it doesn't necessarily make sense to fund in the market. So, the Whole Loan Sale process gives you another funding opportunity."
>
> **Originator**

# The need for Whole Loan Sales

# The Australian experience

Originators do acknowledge the advantages of Whole Loan Sales and understand the circumstances that could prompt their consideration. However, very few have actually proceeded with such transactions. Interestingly, some have suggested that the impetus for considering a Whole Loan Sale is often more likely to originate from an investor rather than the originator themselves.

In the Australian landscape, the need for Whole Loan Sales hasn't been so compelling as to result in a consistent flow of transactions. For most participants, direct experience with such transactions has been limited, occurring once or twice over the course of their career, if at all. While many are aware of instances in the market, few have actively been involved in them. On the funder side, there has also been limited involvement in Whole Loan Sales in Australia.

While experience with these transactions in Australia may be limited, participants' curiosity about them knows no bounds.

> "In my previous role, at a bank, we were involved in some Whole Loan Sales transactions for one of the non-conforming non-bank lenders and that was probably an example of where it kind of does work in that you had an institution that wanted to show growth in its balance sheet and you had an institution on the other side of the transaction that was agnostic about whether its balance sheet was perceived to grow, but more needed additional future capacity, and maybe some income."
>
> **Originator**

> "As a European-based global institution, we do see a fair bit of this type of funding being used offshore, both in the US and in Europe but in an Australian context, while there is a little bit of that going on, it seems to me there is more talk for now, than action."
>
> **Originator**

# The benefits

Participants easily cited a swathe of benefits for both buyers and sellers of whole loans, as evidenced in the table below.

| Benefits for originators | Benefits for purchasers |
|---|---|
| 1. Diversified funding | 1. Get the upside and the downside |
| 2. Access to funding | 2. If you want scale |
| 3. Source of liquidity | 3. Benefit for banks for non-core assets with higher risk weighted charge |
| 4. Free up capacity to write new loans | 4. Should derive a better yield |
| 5. A way of dispensing with non-core assets | 5. Cuts transaction and regulatory costs |
| 6. Can save capacity for core assets | 6. Great for institutions with long dated liabilities |
| 7. Broaden investor base | 7. It's simpler for both parties |
| 8. Frees up risk in equity | 8. Alignment of both parties in transaction |
| 9. Can be cheaper particularly when financer seeks to cover 100% | |
| 10. Appetite from financer for collateral outside normal warehouse criteria | |
| 11. Can broaden an originator's offering | |
| 12. Don't need capital at the bottom of the structure | |
| 13. Minimises impact of RMBS volatility | |
| 14. Capital efficiency | |

With so many benefits listed by industry participants, the obvious question becomes why there has been so little activity in Whole Loan Sales in Australia.

If we look through the themes from a seller's perspective, there are growth and cost benefits, while buyers can potentially take advantage of access to a larger volume of quality assets that may be better aligned with their needs and goals.

## Originator benefits

While the benefits may differ depending on the originator type, a key attraction for them is that Whole Loan Sales offer an alternative to securitisation.

In the current environment there are several reasons why originators may be looking for an alternative to securitisation.

**For non-banks it is becoming more challenging to get funding as they grow.**

> Some Australian banks have pulled back a little bit in financing the non-banks, and we've seen in a big way they've stepped up this year and they're doing a lot of private placements. Their ability to do large private placements is effectively killing any other options out in the market at the moment.
>
> **Global Financier**

> The primary purpose is still for funding right to free up capacity to originate new loans.
>
> **Global Financier**

**RMBS markets experience periods of volatility.**

> RMBS markets can be reasonably fickle, and we've seen quite violent gyrations in terms of the demand for RMBS, both during the GFC, and then the period following COVID, and so if you're a lender and you want to diversify out and hedge a little bit of volatility attached to RMBS, finding a partner who has a slightly different set of needs, and therefore is subject to slightly different cycles is a good diversification plan.
>
> **Originator**

**It is very difficult for non-banks to compete with majors in prime mortgages.**

> It's partly chicken and egg. So what stops or makes volumes of non-bank lenders so volatile, particularly in the prime space, is exactly the dependence on a very volatile funding equation. The reason that non-banks have been hit particularly hard in the prime sector in the last couple of years is that the funding advantage is within the main banks, it's just widened with the TFF and the record number of deposits coming out of COVID.
>
> **Originator**

**Originators often seek better ways of managing non-core assets whether it is a bank looking to divest itself of a particular segment within their book or a non-bank seeking to fund assets that don't fit their warehouse criteria.**

> They're banks and institutions cutting non-core and you look at small portfolios, and look at institutions, perhaps saying, I don't want this book because it's not really my yield requirement or my return on equity requirement, or there's scarce liquidity which I don't have capacity for, and I don't want to set aside capacity for that.
>
> **Originator**

**Capital efficiency is another key benefit that comes with Whole Loan Sales.**

> From a capital efficiency point of view, it can be very interesting because you do end up retaining a little bit of capital. RMBS is still capital efficient, but in a whole loan deal, you really are filling down the full stack, and it's capital efficient there. The transactions themselves can be very efficient because you tend to deal with a single party, and you're not necessarily incurring a lot of the transaction related fees. Particularly if you enter into an arrangement where there's repeat flow, it's a bit of setup cost, and then it's very efficient. So from an issuer point of view, it can be very attractive.
>
> **Originator**

**Whole Loan Sales can also potentially broaden the investor base.**

> Mortgages are long-duration things and some asset managers, whether it's a pension fund or insurance, have long-dated liabilities. So there's a duration matching, which happens quite naturally in those markets as well.
>
> **Originator**

## Funder benefits

Benefits to the funder will depend on the type of funder and what they are trying to achieve. For example, local banks may require assets on their balance sheet or insurance companies may need longer duration assets. Others may be seeking yield via assets that don't fit the typical criteria that can be accessed via RMBS.

The process can be quicker and simpler for funders looking for growth and with experience in Whole Loan Sales than following the traditional path.

> "Imagine you're a listed entity or you're a bank, and you'd like to show your assets are growing, you might at a given moment have plenty of capital and lots of funding, but you're struggling to get the asset growth that you could potentially accommodate given your capital position and your funding position. Well, this is a simple way to just go buy a book, buy a chunk of assets. It's relatively simple. So, for me, it feels like a moment in time solution where you've got both parties to the transactions having aligned needs rather than an ongoing, semi-permanent part of your funding cycle."
>
> **Originator**

**Funders may see the relative value as attractive.**

> "It becomes a relative value play. Do you want to own a triple-A or a double-A or a triple-B or a double-B at whatever spread? Or do you want to own the whole loan in itself at 6.5%, or 8%, depending on where you're playing and what sort of loans you're playing with?"
>
> **Global Financier**

**There may be interest from a financier to fund the buyer.**

> "We're a finance company. Where a bank or a lender can come into play is in the whole loan, the natural owner of a whole loan doesn't want to take 5 million or 10 million; they probably want to buy it in chunks of 200 million, 100 million or 50 million, so you need someone to help with that."
>
> **Global Financier**

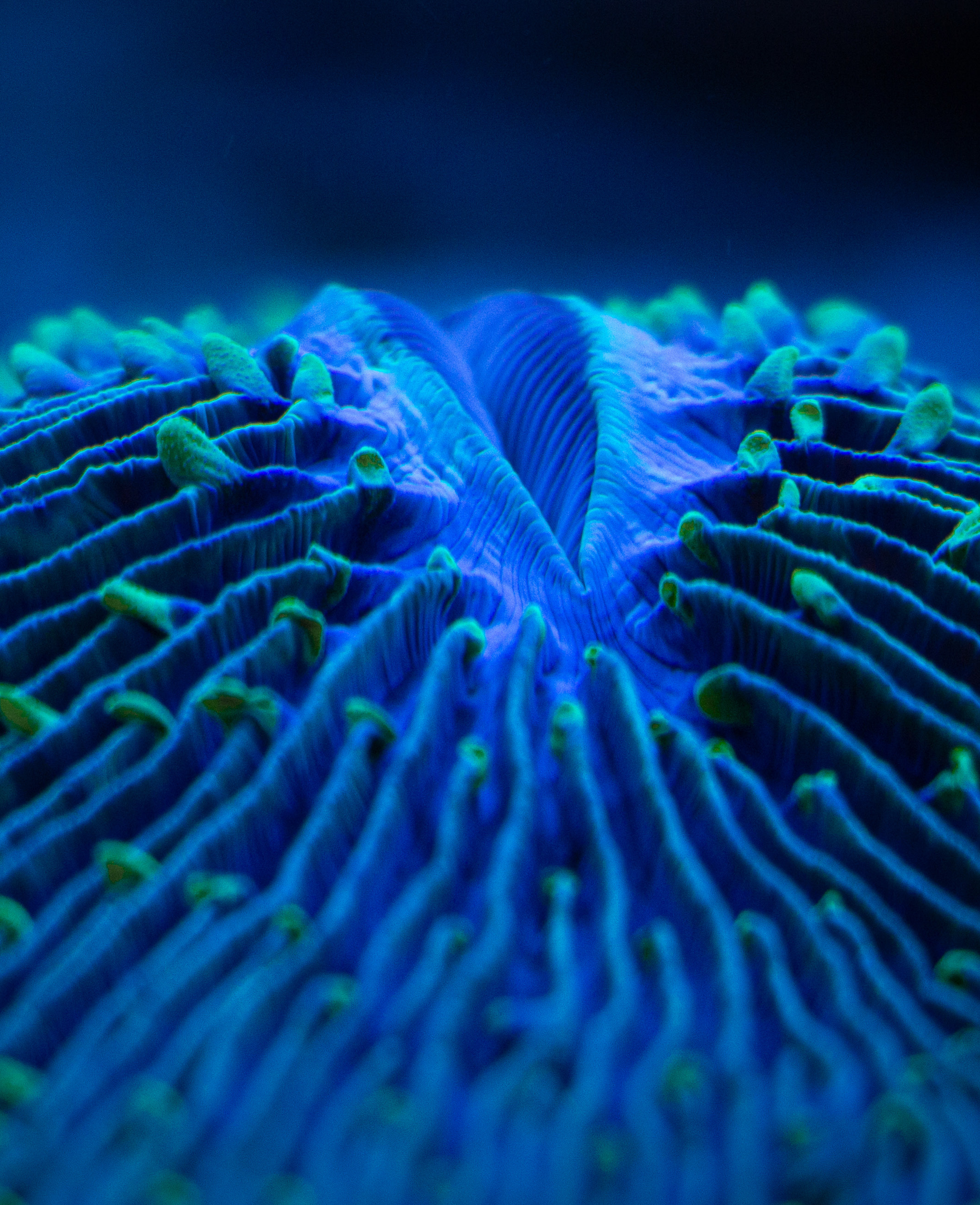
**Some buyers, such as insurance companies, like the long-dated nature of the assets. Others may be interested in assets that don't fit the standard criteria delivered in term markets or via warehouses and this can deliver benefits to both the buyer and the seller.**

> "In some cases, the financier might have an appetite that is outside of your product or your normal warehousing criteria, so it adds another product set or some variation to the existing product set."
>
> **Originator**

> If there was a financier with an appetite for assets, which are different to what I'm currently offering in the marketplace, it allows me to broaden my offering for the market, and hence, that would make sense to me, providing that both myself and the financier stand to make some money out of it.
>
> **Originator**

> Longer duration exposures is something that is a challenge for a funding platform that's based on securitisation, and there are certain products out there both in the SME space, and particularly in the RESI space, that do have longer duration profiles than what traditional securitisation funding structure would have.
>
> **Originator**

# The barriers



While there are several barriers, none seem insurmountable, yet they are sufficient to have limited the incidence of Whole Loan Sales in Australia. The primary barrier is the convenience of accessing funding via RMBS markets or warehousing. Funding may have been tight or challenging at times but there has still been enough to satisfy the majority of issuer needs. While future funding is not guaranteed, and market participants agree that Whole Loan Sales provide a sound form of diversity in their funding arrangements, only some have taken this path.

The lack of experience with Whole Loan Sales is a contributing factor, with several amongst those who completed our poll citing **complexity, effort and access to expertise and market standards** as factors limiting their interest in Whole Loan Sale transactions.

The chart below shows participants' incidence, citing specific factors limiting interest in Whole Loan Sales.


While convenience does not appear at the top of this list in the detailed discussions with market participants, it was clear the lack of an immediate need to seek an alternative to current funding arrangements has limited the number of participants who have thoroughly reviewed its potential.

The other dominant factor highlighted through the poll was the apparent lack of demand for Whole Loan Sales, but interestingly many participants feel there are potentially new investors for this type of transaction. There is awareness that private equity firms and insurers might be interested in this type of transaction, yet in the absence of formal approaches from potential investors it seems the demand may be limited.

A key limitation shared by buyers and sellers is the perceived difficulty in getting the pricing right, making it hard to assess the true value of a potential sale.

> "I definitely think there's a place for it. I understand there haven't been that many done in Australia. It's not a form of funding that is as prevalent here as Europe. I think one of the issues really is just about getting down the value of the acquisition price because, obviously, it really depends on what your assumptions are, and how fast the CPR in that portfolio will project to determine the price of the assets that you're going to acquire. One or the other side may be short-changed as a result of it."
>
> **Global Financier**

The core concern lies in assessing the potential for overcoming these barriers with the increased adoption of such transactions in Australia. Certainly, expertise will enhance as more transactions take place, and this improved proficiency will instil greater confidence in valuing assets for this type of sale. Predicting future demand is more challenging, but there is optimism within the industry that these transactions could attract new investors and, ultimately, foster sector growth. In the interim, the convenient access to existing sources of funding may prevail as the primary obstacle.

> A lot of issuers haven't had to consider these alternatives as yet, but if the market becomes a little more challenging, then diversifying your funding by using Whole Loan Sales as an alternative will be valuable. But over the last couple of years, that really hasn't been an issue for a lot of issuers.
>
> **Global Financier**

> These ideas are interesting but when capital markets are working properly and efficiently, we've got plenty of warehouse funding, so these alternative sources of funding aren't necessarily at the forefront of people's minds.
>
> **Global Financier**

Value and quality are foundational principles that underpin RMBS markets across all market conditions. A Whole Loan Sale transaction represents a significant departure from the way most issuers seek to grow revenue.

> If we are looking to realise an equity value in a book by selling it, that's a fundamental change to the way in which we have structured our revenue base, and that's a revenue base the equities market is generally comfortable with. So that's probably the major challenge.
>
> **Originator**

> So when you're selling an asset, you have to pay a premium, and that's largely a function of discounting the future NIM of that particular loan itself. Now, if that loan refinances within six months, then you've definitely overpaid for it. Or that particular borrower ends up paying down the loan a lot quicker than we originally anticipated, the acquirer has obviously paid too much for that loan. So those assumptions on CPR losses are things that you have to project, and you're never going to know until that happens but that goes into the price of the premium you pay.
>
> **Global Financier**

Some of the less common barriers to participation in Whole Loan Sales include the potential negative impact on the issuer's brand, the internal mechanics of getting this type of transaction approved and a possible negative impact on an issuer's RMBS pricing.

> Originators don't really want to sell their future income, which I have to say I kind of applaud. I think it's a good feature of our market, that we haven't got a ton of people out there who are just hooked on origination, and the fees associated with that, and then selling the future income.
>
> **Global Financier**

> We, as a listed entity, want to show strong asset growth, that's seen as part of the story long term, so as a funding solution compared to others, unless the economics are dramatically compelling, you have to balance that against the fact the size of your asset book is smaller now than it was and how that is perceived.
>
> **Originator**

> I've always floated the idea of us as a shop participating in whole loan acquisitions and then issuing RMBS on our own platform, which is kind of interesting but, like I said, there are so many internal hurdles before something like that can happen, it's almost a bit of a pipedream for us at this stage.
>
> **Global Financier**

# The practicalities

Several topics were canvassed relating to the practicalities of undertaking Whole Loan Sale transactions, including managing the sale process, the role of the servicer, data management and reporting and intermediation.

There was a general consensus entering into this type of transaction for the first time comes with inherent challenges and complexity. Equally, participants felt that the first transaction would be the most complex, with future transactions no more challenging than a term RMBS transaction.

> "Certainly, I think the first would be the hardest, and then it becomes easier after that because people get used to the idea of what it is and how it works and particularly the sort of systems and processes and calculations around the asset."
>
> **Originator**

Most agreed there may be more scrutiny of the servicing and the need for comfort that the originator maintained a regime of high-quality servicing. The majority felt the servicing was best left with the originator and that it would be a rare buyer who could effectively manage the servicing and/or would want to undertake the task of transferring the responsibility for servicing from the originator.

> "I've been around long enough to see that moving accounts from one bank to another, is not an easy thing and I think that if you want to pick up the whole experience of a few 1,000 borrowers and move it to a new bank, and keep everything intact, yeah, that's actually quite a big undertaking."
>
> **Originator**

While most did not believe the information requirements of a potential buyer would differ greatly or at all from what is required for an RMBS transaction, many felt a more sophisticated platform for monitoring and reporting the performance of the loan would be beneficial particularly to aid reporting to internal stakeholders whose scrutiny of the economics may be magnified for this type of transaction.

Several felt this transaction would minimise the need to involve third parties and that the process could be relatively easily managed via a bilateral agreement.

> "It's sometimes an easier discussion to have bilaterally rather than meeting with dozens of investors and getting a long way down the process before we need to backtrack and potentially restructure. Each process has its pros and cons, but for this less common approach, it was easier for us to do bilaterally."
>
> **Originator**

There are differences of opinion about the complexity of undertaking a Whole Loan Sale with some feeling it would be easier and others claiming it would be quite the opposite.

> "Whole loan trades take forever, there is a lot of work that needs to be done to get something like that done. If you've got a program, your first one is a nightmare."
>
> **Originator**

Ultimately, there was a belief that an originator who could implement a program rather than a one-off transaction would be more likely to reap the benefits.

> It's like creating your own platform because obviously, you'd want to do repeat transactions otherwise the cost of doing one trade, you got a sale and purchase agreement, you got warranties, and indemnities yada, yada, that's all cost prohibitive at the end of the day, right? So, you probably really want to have a regular program.
>
> **Originator**

One reoccurring issue was the buyer's response to market factors such as rising interest rates. Originators value their reputation and would be concerned that entering this type of arrangement would impact the relationship they have with their borrowers.

> It's an arrangement where you need to find a degree of alignment in terms of what a financier would do in circumstances such as an interest rate rise versus the originator at the coalface and how they view customer experience, for us customer experience is actually quite an important factor so if we're selecting a whole loan partner, we would go out of our way to make sure that we have terms and conditions and a way of operating that would not affect, adversely, those customer experiences. So, response times and decision-making processes around reviewing customer rates and all those kinds of things. We want to keep it as seamless as possible from the customers' perspective.
>
> **Originator**

# Data and information needs

Generally, participants on both sides of the deal believed their information requirements would resemble those necessary for an RMBS term deal. Some anticipated a higher level of scrutiny, both to establish confidence with the initial pricing and to ensure the servicer was meeting their expected standards of commitment.

> "You'd probably be scrutinising significantly more than an RMBS, especially depending on where you sit in the stack. If you are a AAA RMBS or ABS investor, those losses are easily absorbed by the mezz or excess spread, but when you're buying it all, you want the extra spread."
>
> **Global Financier**

> "You'd normally buy losses. You don't have anyone protecting you below you, so I can imagine the level of scrutiny around the portfolio would be more significant."
>
> **Global Financier**

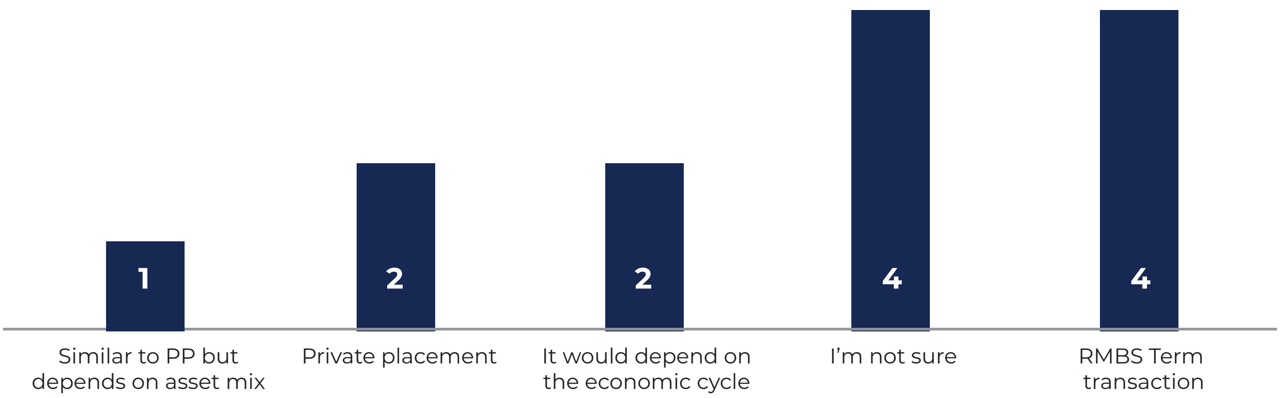
> "But at the end of the day, much of the data that they request is exactly the same. So, everyone's had to make sure that compliance with RBA reporting, so there's nothing really outside of that particular data set that investors are asking for above and beyond that. It really depends on the investor, but generally, we haven't had great issues in providing everything that they need to see."
>
> **Originator**

> "I think it would be more intense or more intensive, there'd be greater due diligence requirements on the origination and servicing capabilities than a securitisation would because in a securitisation, the risk is quite well diversified, plus you also have the benefit of the rating agencies have done a lot of work on the service or in the originator itself. Post transaction reporting, though, I think it would be probably like a securitisation. The whole loan acquirer would have direct exposure to, in a corporate sense, to the seller who would be doing the servicing on the book. So that's probably a different element to it. They'd need to do their work on the quality of the business and how it would run in different cycles as well."
>
> **Originator**

# Pricing and value

All participants agreed value would need to be delivered to both parties for a Whole Loan Sale arrangement to be viable. However, determining the price and, thus, the relative value would not be inherently easy. In the quantitative survey, the research asked issuers to nominate the most appropriate benchmark for a Whole Loan Sale transaction and received a varied response as shown below.

**What is your most appropriate benchmark for a Whole Loan Sale transactions?**




In the in-depth qualitative research, issuers tended to speak to the bigger picture of funding when considering where the price might be set for this type of transaction. They also noted that it would depend on the way the deal is structured so there is no single answer to what should be used as the benchmark and where the pricing would be set.

> So, there's a lot of different ways you can structure it. You can sell off all of the NIM, you can go into a profit-sharing arrangement with an investor, you can continue on with the servicing, or you can just dispose of the loans completely. So, depending on what actual approach you want to take, it can quite dramatically change what the pricing should be for that transaction and on what the objectives of the trade are.
>
> **Originator**

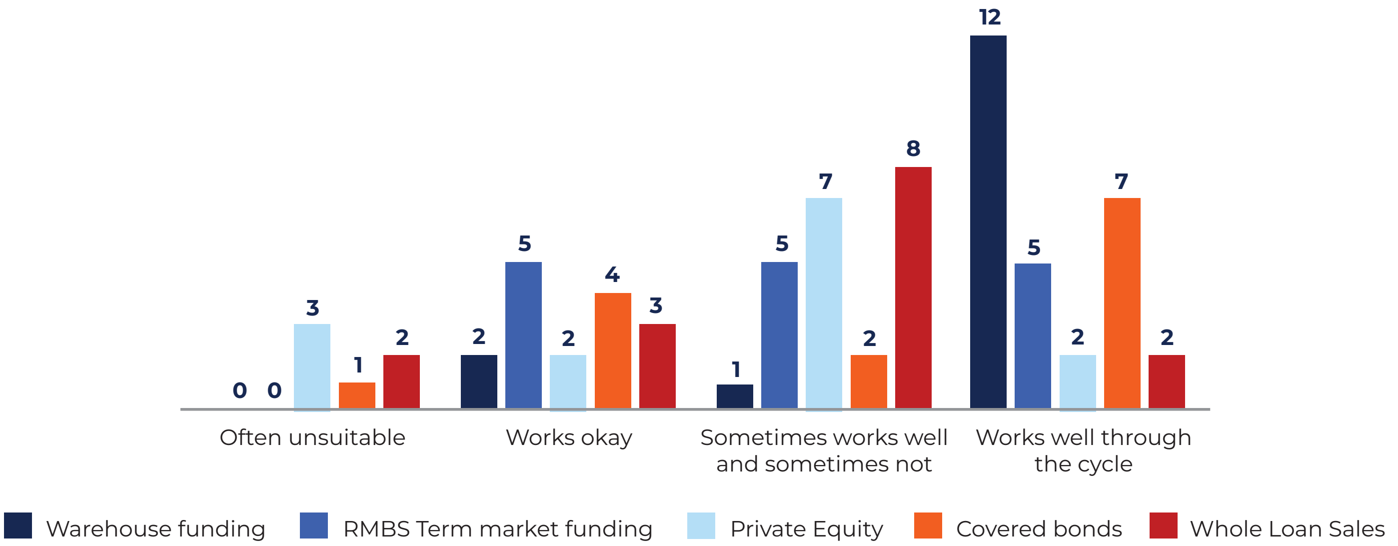
> Okay so, does it make sense? What does pricing look like versus our warehouse? What's the impact going to be on the overall funding profile of business?
>
> **Originator**

There were also distinct differences of opinion on the performance of a Whole Loan Sale transaction as a funding option through the economic cycle.  Warehouse funding was perceived to be the most resilient by our poll participants, yet there was a belief that Whole Loan Sale funding would not be suited through all gyrations of the economic cycle.  Many felt RMBS term funding was also not suited to all market conditions.

Most agreed originators would expect the need to consider the foregoing margin relative to their benchmark, at least in some circumstances, for a Whole Loan Sale transaction.

With more experience of these transactions these issues may be clearer.  One issuer experienced with Whole Loan Sales made the point that it's important to ensure the incentives of the buyer and seller are aligned when setting the price so that "We're in the same boat together".

**How well does each funding option work through the economic cycle?**



# Target investor

One of the highlights of the research was the widely held view this type of transaction could lead to an expansion of the local market by meeting the needs of global or regional investors who are not currently active in the Australian market.

In particular, insurers and private equity firms are believed to be bright prospects and local super funds also may be a promising group of potentially new investors in Australian mortgages.

Insurance companies are perceived to be a natural target for this type of loan as they like the annuity aspect as well as the tenure. One participant mentioned that insurance companies prefer holding commercial real estate and receiving an economic benefit over investing in a trust.

It is felt that buyers are attracted to the residuals and the prospect of getting access to a decent volume in the junior tranches.

While several felt that super funds would be a natural buyer for this type of asset, they equally felt that mandates of super funds might need to change and skill sets developed before they could effectively participate.

Broadly speaking, originators felt Whole Loan Sales would be particularly attractive to investors seeking yield and, thus, those with a higher appetite for risk. These included credit funds or private equity firms with fairly large yield hurdles.

Some felt ADIs could also be likely buyers, particularly when they have a strength in deposits.

> “If there’s a bunch of ADI’s in this market who are long deposits, and they have a very concentrated and smaller mortgage proposition, but they’re very good at gathering deposits. So deploying that capital this way, in an APRA-regulated environment makes a lot of sense.”
>
> **Originator**

As much as originators can see the potential for an influx of global investors for Whole Loan Sales, they are realistic about the factors that may have prevented these investors from operating in the Australia market in the past.

> “The mortgage market is huge, and it’s high quality and it’s well regulated, and these are brilliant assets. There are lots of global investors who would love to have efficient access to those assets, but because of the size of the market here and the lack of depth, they don’t necessarily come in and make that a well-functioning, deep, liquid and efficient market.”
>
> **Originator**

Potential volume is certainly an inhibitor in the minds of some originators.

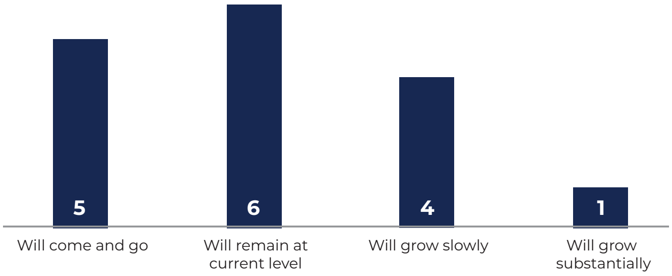
> “As far as larger non-banks are concerned, it would be likely transactions with a large PE firm that would need a minimum size, and I’m not sure what that number is, but definitely north of $250,000,000 to make it work.”
>
> **Originator**

# Prospects

Both originators and financers favour the concept of Whole Loan Sales and in general welcome the growth of a vibrant and sustainable Whole Loan Sale sector, particularly if this means an expansion of the entire Australian mortgage market.  However, few expect this market to grow at speed.

The research suggests this lack of speed is due primarily to the fact participants that had little to no direct experience of Whole Loan Sale transactions.

**What is your expectation of the use of Whole Loan Sale transactions in RMBS/ABS in the next few years?**




However, the general attitude of those interviewed suggests bright prospects for the continuing growth of Whole Loan Sales, even if that growth is incremental.  Many also believe the growth can be sustained.

> I think we've probably only scratched the surface of what's possible in this market.
>
> **Originator**

Of course, the positivity comes with caveats. Many believe either the conditions need to be suitable or something needs to change to make this potential market more viable.  Whether it's a slowdown in volumes in the market, favourable market conditions, regulatory limitations, internal practices and attitudes, lack of visibility of who the new investors are and probably most importantly, pressure on funding from traditional sources.

> Obviously, it's in its infancy. There haven't been a massive number of these types of transactions in this market, but it's definitely one that as the pools of wholesale capital grow fast, and I'm talking about global asset managers, I'm talking about pension plans, I'm talking about insurance companies, as they grow fast, there's money that's going to be looking for a home.
>
> **Originator**

## Additional insights: prospects for a Whole Loan Sale market

The likelihood of slow growth is reinforced by some of the language used by participants in describing the sector prospects:

None of this is short-term

On the demand side, I do think it will probably take some changes in settings

I think it is something that will kind of continue to grow

We probably will see the market slowly develop

They need to get comfortable with taking the whole of that loan on board

The industry needs to do more work

I think it'll grow over the next decade

It's going to take some time

Hopefully it is just a matter of time

I don't think it'll be a huge explosion

On completing the interviews with originators and financiers several key trends emerge. The industry is generally positive towards the concept of Whole Loan Sales, albeit with a degree of caution. Many find it challenging to overcome the perception that the success of Whole Loan Sales may be contingent on economic conditions and the state of securitisation markets. Access to funding will remain a challenge for originators, they recognise Whole Loan Sales have the potential to level out the fluctuations of capital markets, yet starting the process is not easy.

There is a prevailing belief that Whole Loan Sales could attract new sources of funding, which is widely seen as a positive for the industry. However, there are uncertainties regarding sustainability of these funding sources, despite evidence of long-term success in similar arrangements overseas.

Larger non-banks are more receptive to the idea of Whole Loan Sales as an ongoing funding source, especially as they face increasing challenges in securing funding in the prime space. In contrast, smaller originators may struggle with the volumes required to make a forward flow arrangement viable. The prospect of a collection of smaller originators, such as mutuals, coming together to produce a forward flow platform is intriguing, but there is recognition that a suitable platform would be necessary to instil investor confidence in the servicing and management of the loans.

> “Whether it’d be possible for several issuers or a few issuers to get together and work on something together to offer to the market of this kind, I think there’s huge opportunity there. You’re not going to go from zero to a fully liquid tradeable market. If you got one or two issuers, and one or two big purchasers, and you had a standardised way of exchanging data on portfolios of loans, that’s the basis for a market, which has liquidity. You could then have portfolios of loans evaluated, not so much on the issuer, but on the characteristics of the portfolio, and you could have investors purchasing those knowing that they have access to a standard set of data, real time data on those mortgages, so they can see exactly what’s happening with those mortgages, and so they’d have the transparency around what’s in the tin, plus the comfort that if they needed to move out of that, or whatever, they could fully quit.”
>
> **Originator**

There is undoubtedly optimism that the whole loan sector will experience ongoing growth, albeit at a gradual pace. For originators with the greater need to secure funding sources for future growth, it seems likely that Whole Loan Sales will become increasingly pivotal.

Finally, we'll let an originator who fully grasps the magnitude of this opportunity have the last say. While we may foresee gradual and consistent growth in the short to medium term, the sector could potentially experience a slightly faster expansion if more originators share this level of conviction.

> "I do think it will grow substantially, because if you if you look at the two sides of that market, I do think that there is a large mortgage market, trillions of dollar worth.  I think it's very attractive from the point of view of the regulatory environment and the quality of those books, and even if you look through the GFC, the Australian mortgage market performed very well.  So, there is a lot going for it. It's large, and high quality, so it's going to have appeal to buyers, I think there should be willing buyers, and there are players like us and other non-banks ready, that have access to that sort of funding source and originate mortgages that way.
> So on the supply side in terms of supplying those assets, there's a big market to tap there."
>
> **Originator**

# Perpetual Corporate Trust

Perpetual Corporate Trust (PCT) is part of the ASX-listed Perpetual Group (ASX:PPT) headquartered in Sydney, Australia, providing asset management, wealth management and corporate trustee services to local and international clients. Serving Australians since 1886, today our operations span Australia, Asia, Europe, the United Kingdom and the United States.

PCT is a unique combination of businesses with a clear vision to be the most trusted partner in the banking and financial services industry. Our strategy is to enable our clients and the market to be more effective, efficient, economical while managing ever-increasing cyber security risks and maintaining compliance.

Domestic and global financial institutions leverage our corporate strength, best-of-breed risk and compliance management framework, local on-the-ground expertise and service excellence across debt markets, managed funds and digital solutions to support their business strategy. We are commercial, flexible and take a commercial approach to enable our clients to achieve their strategic and business goals, while always acting in the best interests of investors.

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As a leading fiduciary, custodian and digital business in Australia, with dedicated operations in Singapore, PCT supports clients locally and overseas with a unique offering through our four businesses:

- **Debt Market Services** include trustee, document custodian, agency, trust management, accounting, standby servicing and reporting solutions.
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- **Perpetual Digital** provides data services, industry roundtables, software-as-a-service products.

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