



DIRECTION ON INVESTMENT IN RESIDENTIAL MORTGAGE-BACKED SECURITIES 2011

I, WAYNE MAXWELL SWAN, Deputy Prime Minister and Treasurer of the Commonwealth, give this Direction under section 62A of the *Financial Management and Accountability Act 1997*. This Direction is to provide guidance to persons to whom I have delegated powers to invest under subsection 39(2) of the Act. Delegates are required to comply with this Direction, which is to be read in conjunction with my Directions of 3 February 2009 which were tabled in Parliament on 11 March 2009.

Objectives

Over the past 15 years, the market for residential mortgage-backed securities (RMBS) has provided a critical source of funding for small lenders to compete with the major banks. However, developments in international capital markets since mid-2007 dramatically reduced liquidity in the RMBS market and constrained the ability of smaller lenders to access vital funding from this source.

In view of these developments, on 3 October 2008, 16 October 2008, and 30 November 2009, I directed the Australian Office of Financial Management (AOFM) to invest up to \$16 billion in Australian RMBS to support competition from smaller lenders while funding markets remain dislocated. Since the commencement of this important initiative 18 lenders have raised almost \$28.5 billion in funding, with the AOFM investing only \$12.5 billion of this amount.

However, despite significant improvement during this period, the Australian RMBS market remains dislocated and continues to be affected by the fallout from the global financial crisis. While this program is making RMBS funding economic for smaller issuers, pricing levels and issuance volumes have not yet improved sufficiently to accommodate new issuance from a variety of smaller lenders without AOFM support.

I am now directing the AOFM to invest up to an additional \$4 billion in Australian RMBS and the remaining \$3.463 billion from my previous Directions, subject to market conditions. This brings the total investment by the Government to \$20 billion.

The Government's objectives in making these investments are to:

- further boost competition in the mortgage market by supporting smaller lenders;
- provide support for lending to small business, through participating lenders using some of the proceeds of the AOFM's investment for lending to small business; and
- encourage a transition towards a sustainable and innovative securitisation market that is not reliant on Government financial support.

Directions

I direct that:

1. Delegates invest up to \$7.463 billion in Australian RMBS rated AAA or equivalent by one of the major credit rating agencies, subject to market conditions.
2. The AOFM only invest in RMBS sponsored by a lender that clearly operates independently of the four major Australian banks. The AOFM will, in making its assessment, have reference to whether:
 - 2.1. The lender has a major bank as a shareholder, with a direct holding of more than 5 per cent (excluding holdings known to be held as a bare nominee); and/or
 - 2.2. A major bank holds one or more nominee director positions on the lenders' board.
3. The AOFM is to manage the investments in the residential mortgage-backed securities made under this Direction. The securities purchased under this Direction are to be held in a portfolio separate to the AOFM's cash and long-term debt portfolios. The performance of this portfolio will be evaluated separately.
4. The AOFM may enter into repurchase arrangements using residential mortgage backed securities purchased under this Direction, or other securities purchased under my Directions of 3 February 2009, for short term financing in its management of Official Public Account balances.
5. The AOFM may adjust its holdings of securities purchased under this Direction to take account of changes in their characteristics and credit quality or to provide better balance in its holdings of these securities.
6. After conditions in the primary residential mortgage-backed securities market have improved, securities purchased under this Direction may be realised or, at the AOFM's discretion, may continue to be held as part of its total investment portfolio, taking account of the objectives of this Direction and the expected return and risk on these securities in relation to the management objectives of its total portfolio. Sales of the securities should be undertaken without causing market volatility. Note that this direction does not limit directions 4 and 5.

In the event that an investment made in accordance with these Directions and my Directions of 3 October 2008, 16 October 2008, and 30 November 2009 ceases to meet the specified requirements, it may continue to be held to maturity or until it can be sold at an acceptable price.

Pursuant to paragraph 62A(5)(b) of the Act, I direct that delegates must comply with any instructions relating to administrative arrangements, procedures, limits, controls or other matters of detail relating to investment within the framework established by this Direction and my Directions of 3 February 2009, where those instructions are given in writing by the Secretary to the Treasury or by the Chief Executive Officer of the Australian Office of Financial Management.

Dated



this day of

April

2011

WAYNE MAXWELL SWAN

Treasurer of the Commonwealth of Australia