ASSET SECURE

Ms Sarah Alland
Financial System Inquiry
GPO Box 89
Sydney NSW 2001

7 April 2014

Dear Sarah

As per our telephone discussion on Friday, I am pleased to attach the Assetsecure submission to the FSI.

We apologise it is a week late and appreciate the FSI extending the deadline.

Please do not hesitate to contact either Terry Hartan, Director, Assetsecure on 02 8274 2892 or me on 02 9251 8055 if we can be of further assistance.

I also attach a brief overview of Assetsecure.

Yours sincerely

Peter Wedgwood
Chairman

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ASSET SECURE

ASSETSECURE PTY LTD

Submission to the Financial System Inquiry

4 April 2014

INTRODUCTION

- Australia boasts capital markets of over $3 trillion.
- Over 98% of Corporate Australia (i.e. companies with turnover > $50m) **cannot** access these markets for corporate debt.
- Corporate Australia employs over 3 million Australians.
- Fundamentally, corporates cannot issue bonds **unless** they are investment grade rated by S&P, Moody's and Fitch.
- For funding facilities over $30m, Corporate Australia primarily has only four sources – the D-SIBs (ANZ, Commonwealth Bank, NAB and Westpac).
- As a 'financial regional centre' Australia D-SIBS have not advanced in recent years in offering Corporate Australia, innovative funding. Plain vanilla senior debt loans are the order of the day.

PURPOSE OF THIS SUBMISSION

To support the ability of Australian corporates to access the Australian capital markets through the use of securitisation, credit insurance and using an Australian based rating agency - Australia Ratings, as an APRA accredited rating agency.

The ABS securitisation industry is heavily weighted towards the RMBS sector [currently $28bn] whilst other ABS account for less than $3bn.

These non RMBS ABS have allowed the following assets to be securitised:

- Trade receivables.
- Credit card receivables.
- Lease receivables.
- Commercial Property

Trade Receivables

It is estimated that there is less than $1 billion of trade receivable ABS bonds issued into the Australian capital markets.

This is negligible in terms of bond issuance, and yet, as a corporate assets trade receivables run into the trillions of dollars for Corporate Australia.

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Why has there been an absence of trade receivable securitisation?

Some primary reasons:

- The S&P and Moody's rating agency models for trade receivable structures factor into the equation 'concentration risk', where if any one debtor in a pool of trade receivables is more than 2% of that pool that debtor is extracted from such pool.

  The problem in Australia, with this concentration risk issue is that most trade receivable pools are dominated by the oligopolies names such as Woolworths, Coles, large mining companies and other dominant industry leaders.

  In Australia, this becomes an anomaly given the fact that where a trade receivable pool has say 40% of its receivables in the name of debtors such as Woolworths and Coles, then those receivables are eliminated for funding purposes and yet, they represent the strongest credit in the portfolios.

  The S&P, Moody's and Fitch models were established in the 1970s in the USA where trade receivable pools were a multiple of Australian pools (in size) and there were few cases where any one debtor represented more than 2% of these pools.

  This is but one example of where S&P, Moody's and Fitch criteria were devised in the USA and the models have not been adjusted for different global environments.

Other impediments are:

- The owner and servicer of the receivables (i.e. Corporate Australia company) essentially need to be an investment grade entity to allow ABS bonds to be minimally rated investment grade. There are less than 50 S&P/Moody's investment grade companies in Australia out of a population of 3,000. This means only 1.5% of Australian companies are eligible for non-enhanced bond issuance (and thereby access to capital markets).
- The average size of trade receivable pools for Corporate Australia are in the vicinity of $30m - $50m. These amounts are generally too small to undertake a one-off bond issue into the Capital Market. Front-end costs and lack of liquidity also prohibit access to capital markets.
- By their nature, trade receivable assets have a high 'churn' factor. That is, every 30 – 90 days these assets are converted back to cash and new receivables are generated into the pool.

  Both the correct recording of eligible invoices and the managing of the cash flows require sophisticated IT platforms for a large administrative staff. Only a handful of IT platforms are available in Australia.

PROPOSAL TO FINANCIAL SECTOR INQUIRY

To allow Corporate Australia (with its 3 million workforce) to access the capital markets by issuing ABS and thereby have an alternative and cheaper form of working capital finance, it is proposed:

1. Make it easier for ABS issues to be undertaken by allowing Australian ABS structures to be credit rated by Australian Ratings. This is a key recommendation, as the Australian rating regime is held captive by S&P, Moody's and Fitch – all three USA owned and dominated. We understand that Australian Ratings have to achieve an "impossible" accreditation process under current APRA requirements resulting in minimal presence.

2. By having an official rating ABS bonds will be easier to sell into capital markets.

3. Make it mandatory (or encourage) fund managers to invest up to 2% of their portfolio in ABS securities. Based on a $3 trillion market this equates to $60 billion.

The majority of fund managers are restricted in investing only in A or better rated (S&P and Moody's) interest yielding bonds. This reduces the opportunity to issue sub A rated bonds into Australian capital markets where less than 5% of super funds can invest in such instruments.

If funds are prohibited, through their own policies, from investing a small portion of their interest yielding investment in sub A rated instruments then the likelihood of corporate Australia accessing funds from the capital markets will be futile.

To overcome the problem of inferior ratings, the insurance sector comes into play. Since the 1950s, the insurance sector is the largest provider of credit insurance covering trade receivables. Without credit insurance both Europe and the USA would have difficulty in maintaining their respective economies as most industries cannot operate without trade credit protection.

Through the use of credit insurance and credit enhancement the insurance sector is in a position to upgrade the rating of trade receivable pools to levels from AAA down to A- depending on the structure and risk exposure of each pool. By the utilisation of insurance products, Corporate Australia would be able to issue A or better rated bonds. The insurance sector is, in over 90% of cases, able to insure against credit default of large debtors such as Woolworths and Coles.

It is important to note that the reference to credit insurance and credit enhancement has no relation to the 'wrap' insurance product which was previously offered by insurance monoline companies.

SUMMARY

- It is essential that Corporate Australia has additional avenues of finance other than the four D-SIBs of Australia.
- The $3 trillion capital market has the capacity to fund an estimated $6 billion of ABS trade receivable needs ($6 billion represents **.2%** of capital markets).
- Through the use of trade credit and credit enhancement insurance, Corporate Australia will be able to issue ABS notes that can be rated A or better by Australia Ratings.
- Investors in these ABS notes will achieve a number of benefits:
  - The yield on ABS notes will be comparatively higher than other interest yielding alternatives such as bank term deposits.
  - The ABS are simple interest bearing securities. They are not:
    - Hybrids
    - Convertibles
    - Long term in nature
  - The majority of capital market funds are derived from superannuation contributions from Australian employees. What better way for employees of Corporate Australia to assist Corporate Australia in achieving better options in having access to the capital markets.
  - No default has occurred on any trade receivable backed bonds in Australia.

Program Overview - Assetsecure

- Assetsecure has been operating for 9 years in Australia as a specialist provider of trade receivables securitisation funding facilities for non investment grade, large Australian corporates, requiring non recourse committed funding from AUD$15M to AUD$100M. Assetsecure is owned by shareholders of Assetinsure, an APRA regulated insurance group and Challenger Group Ltd ("ASX CGF"), and key management.

- Assetsecure operates a rated internet based receivables service platform that is unique to the Australian market and able to service automated, large data downloads daily from our clients and provide instantaneous reconciliation of receivables, daily reporting and daily funding for clients as required.

- Assetsecure funding is in the form of unsecured floating rate notes, committed for a minimum of 3 years. Notes are purchased by 2 of Australia's largest fixed income investors, Industry Funds Management and Challenger Life Company (ASX CGF), Challenger is also a large shareholder of Assetsecure.

- The Assetsecure funding proposition is to support provide incremental access to liquidity and working capital funding for clients advancing up to 90% against trade receivables on a committed junior secured basis, typically in conjunction with one secured senior bank lender who is not stretched to gearing limits for an asset intensive middle market customer