Assignment of Mortgage Loans to the Special Purpose Vehicle in Securitisation Programs

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Introduction

Securitisation is the process by which a credit institution, either a bank or an independent mortgage provider (IMP), sells[1] assets on its loan book (specifically, accounts receivable on its loan book) to another financial intermediary. The financial intermediary then funds its holdings by issuing asset-backed securities to investors. By this process, the original illiquid asset (e.g. a residential mortgage loan, credit card receivable, or motor vehicle lease) is transformed into a tradeable, more liquid debt security.[2]

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1 Alternatively, funding may occur by sub-participation. In a sub-participation investors lend to the financial intermediary (e.g. the SPV), which then on-lends to the original credit institution an amount typically equal to the market value of the pool of assets (in order to show regulatory authorities that the transfer is *bona fide* and 'at arms length'). Sub-participation does not remove the investors' credit exposure to the original credit institution. For a more comprehensive discussion of sub-participation, see T. Frankel, *Securitization: Structured Financing, Financial Assets Pools, and Asset-Backed Securities* (1991) Part III.

2 Theoretically, any income-producing asset can be securitised. For example, assets that have been securitised in the United States include home mortgage loans, commercial property mortgages, consumer receivables (car, boat and truck loans, credit card receivables, TV rentals, mobile home loans, student loans, health care receivables, telephone charges), trade receivables, equipment leases, (e.g. aircraft leases), bank loans (sovereign debts, even project finance loans), bond portfolios, and third world debt: see J Hu, R Pollsen and J Elengical, 'A Record Year for Residential MBS' (2002) 62 *Mortgage Banking* 36; J C Shenker and A J Colletta, 'Asset Securitisation' (1991) 69 *Texas Law Review* 1369, 1380; and G Salathe, 'Reducing Health Care Costs through Hospital Accounts Receivables Securitization' (1994) 80 *Virginia Law Review* 549.

In Australia, the most commonly securitised asset to date has been residential mortgages. Other assets that have been securitised in Australia include commercial mortgages and leases, (office buildings, shopping centres and warehouses), credit card

In a typical mortgage-backed securitisation program, a housing loan provider, generally referred to as the originating bank[3], 'pools' selected housing loans. Then the originating bank (for a price) transfers its rights under the relevant loan agreements to a special purpose vehicle (SPV). Which then (again for a price) issues notes or bonds to institutional investors. In Australia, the SPV is invariably structured as a trust.

In most residential mortgage securitisation programs, the bank that originally issues the housing loans is the originator of the mortgages securing those housing loans; that is, the lending and mortgage originator roles are both embodied in the one organisation, which transfers its rights under the loan agreements to the SPV. However, in some other mortgage securitisation programs, the lending bank is a separate entity from the mortgage originator, and it is the mortgage originator that transfers its rights as mortgagee to the SPV.

The rights transferred to the SPV (sometimes through a mortgage originator) include the lender's right to receive principal and interest repayments from the borrower. They also include the lender's right to exercise its power of sale under the terms of the residential mortgage and the lender's right to any mortgage insurance payout in the event of default by the borrower. These rights of the original mortgagees must be transferred to the SPV in a manner that is legally effective and commercially practical.

In terms of legal theory, a transfer of mortgagee rights from a mortgage originator to a third party could hypothetically be effected by legal or

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receivables, share loans, corporate loans, utility receivables, trade receivables, automobile loans and consumer finance receivables, infrastructure assets such as pipelines, toll roads, ports, water treatment plants, electricity transmission assets, employee share scheme loans: see Macquarie Bank Homepage http://www.macquarie.com.au; and Standard & Poor's, 'RMBS, CDO Activity Lead Australian Securitisation Issuance Growth in 2003' *Credit Ratings Commentary and News* (2003).

3 Since 1996 most banks have been forced to establish RMBS programs because of increasing competition in the housing loan market in Australia. While banks remain the major source of housing finance, non-bank lenders currently comprise more than one-fifth of all new lending. The success of the non-bank lenders is due in large part to product innovation, greater borrower accessibility through the introduction of mobile lenders, extensive origination networks, and the ability to securitise their housing loans through RMBS programs. For more detail, see Standard & Poor's, *An Investor Guide to Australia's Housing Market and Residential Mortgage-Backed Securities*, (2003) 18-19.

The main originating banks in Australia are banks such as Macquarie Bank, Westpac, Commonwealth Bank, Citibank, St George Bank and Adelaide Bank: see Standard & Poor's, *Structured Finance Australia and New Zealand* (2000) 14. In this context, the originating bank will generally be the 'sponsor' (or promoter) of the program.

equitable assignment.[4] Under an effective legal assignment, the mortgagee's rights would be vested absolutely in the SPV. Under an equitable assignment, the SPV would be recognised in equity as having acquired those mortgagee rights. However in law, the transferor would remain their legal 'owner', holding the mortgagee rights on bare trust for the SPV as trustee for the bondholders.[5]

In practice, most of the smaller banks and IMPs equitably assign their mortgages to a 'warehouse trust fund' or 'sub-fund' administered by a larger bank, which sponsors the residential mortgage-backed securities (RMBS) program. In such a case the instrument of assignment typically provides that the transfer is to be perfected or completed in particular circumstances,[6] such as the mortgage originator entering into administration or going into liquidation.[7]

Ultimately however, the mortgagee rights in most Australian RMBS programs are, in practice, sold by way of legal assignment to the SPV that issues the RMBSs, which then becomes the 'lender of record' for these housing loans and ultimately receives all repayments from borrowers. In purchasing the mortgages in this way from the originator at their market value, the trustee (or security trustee, if any) of the SPV becomes, in law, the mortgagee of the residential properties in the pool.[8]

The assignment or transfer is typically structured in such a way that mortgages in the pool are separated from any insolvency risks associated with the originator. To use the U.S. expression that has found its way into the Australian market nomenclature, the assignment or transfer is structured so as to be 'bankruptcy-remote'[9] to gain investor acceptance in

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4 These concepts, and their relevance to residential mortgage-backed securities (RMBS) issues, are discussed in more detail in Part 3 of the article.

5 See for example the Macquarie Bank's PUMA program: Macquarie Securitisation Ltd, *Master Information Memorandum, PUMA Fund P-12* (3 April 2006) 40, 54 https://www.macquarie.com.au/security/login.html?urlto=https%3a//www.macquarie.com.au/pumainfo&urlfrom=http%3a//www.macquarie.com.au/index.html at 20 May 2006.

6 See D Glennie et al, *Securitization* 1998, 4-5.

7 The consequences of the mortgage originator becoming insolvent are discussed in further detail in Chapter 7 of the author's PhD thesis: Pelma Rajapakse, 'Residential Mortgage Securitisation in Australia: Some Suggestions for the Reform of Commercial Law and Practice' (2004).

8 While the trustee (or security trustee, if any) of the SPV holds the legal title to the residential mortgage loans, investors in the RMBSs acquire a concomitant beneficial interest by paying a price for the loan receivables equal to their present value. This present value reflects the rate of return the trustee-issuer wants to offer to the investors, and must be lower than the inherent rate of return of the loan receivables if the overall transaction is to be profitable.

9 Insolvency remote in this context means that the SPV is unlikely to be adversely affected by a bankruptcy of the originator. Such insolvency issues are discussed in Chapter 7 of the PhD thesis in the above note 7. See also T J Gordon, 'Securitization

the capital market securities.[10] In general, this is achieved by ensuring that the assignment or transfer constitutes a 'true sale' by the originator to the SPV. Provided the sale is perceived to be 'arm's length' at a genuine market price, and its timing is at least six months before any stakeholder insolvency, then even if the mortgage originator becomes insolvent the mortgaged properties in the pool will generally, under insolvency law, be insulated from other assets of the originator that may be used to satisfy its creditors.[11] The separation of the originator from the mortgaged assets generally also enables funds to be raised at less cost (through securities issued by the SPV) than if the originator were to raise funds in its own right.[12]

As noted above, in structuring an RMBS program, banks and other financial institutions must ensure that the transfer of their mortgagee rights to the SPV is treated as a 'true sale' (sometimes termed a 'clean sale' in the overseas literature[13]). A 'true' or 'clean' sale is important so that:

- the authorised deposit taking institution (ADI) can obtain regulatory capital relief from the Australian Prudential Regulatory Authority (APRA) for capital adequacy purposes; to ensure that, so far as is possible,
- the RMBSs are issued by an SPV which is insolvency-remote, so far as the mortgage originator is concerned;
- the issue complies with taxation legislation – eg the transfer must be *bona fide* and at arm's length; and
- the issue is consistent with the law of trusts and equity.

A 'true' or 'clean' sale requires that the originating lender, in assigning its mortgagee rights in equity to the SPV, distances itself sufficiently from the SPV so as to avoid the risk that it is seen to have any commercial (or even, for capital adequacy purposes, 'moral') obligation to support the liquidity of the program or the market value of securities issued, or to

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of Executory Future Flows as Bankruptcy-Remote True Sales' (2000) 67(4) *University of Chicago Law Review* 1317.

10 L R Lupica, 'Circumvention of the Bankruptcy Process: the Statutory Institutionalisation of Securitisation' (2000) 33 *Connecticut Law Review* 199.

11 G Engel and A Koslow, 'Securitisation Advise for Asset-Based Lenders', in J Cunningham (ed), *Asset Based Financing* (1996) 479.

12 Bankers Trust, 'Securitisation in Australia' (May 1999) *Asiamoney* 17, 18; Standard & Poor's 'RMBS, CDO Activity Lead Australian Securitisation Issuance', *Credit Ratings Commentary and News*, (July 2003); and A Finch, 'Securitisation' (1995) 6 *Journal of Banking and Finance Law and Practice* 247, 262.

13 A 'true sale' is also referred to as a 'clean sale' under the APRA Capital Adequacy Guidelines: APRA Guidance Note, AGN 120.3, *Purchase and Supply of Assets* (September 2000) www.apra.gov.au.

make good any losses suffered by investors. The mortgage assets assigned in equity include the mortgagee's rights under the mortgage, relevant security property insurance policies and mortgage insurance policies, and the originator's interests in any contracts it may have with solicitors, valuers or other professionals in connection with the origination of the mortgages.

This article focuses on the ways in which the originating mortgagee's rights and the underlying collateral can be transferred to the trustee-issuer and considers the main legal issues that can arise in the RMBS programs. These issues include the extent to which the transfer of mortgage rights to the SPV is a 'true sale' or a mere financing arrangement, which is examined in Part 2. In Part 3, the issues relating to the assignment of the originating mortgagee rights to the SPV will be discussed. Part 4 provides a brief discussion of how the SPV is generally structured in Australia to effect a 'true sale'. Part 5 examines and analyses the impact of the *Consumer Credit Code* (the Code) on RMBS issues, with particular reference to Queensland law. Part 6 provides a summary of the above legal issues and concludes the article with some suggestions for reform of the consumer credit legislation in Australia.

What is a "True Sale"?

In the normal course of events, the securitised mortgages and the mortgagee rights attaching to them are transferred to a newly formed SPV, *inter alia* to insulate them from the credit risk of the originator.[14] If the transfer is not properly effected and structured so that it qualifies as a 'true sale' or absolute conveyance that cannot be re-characterised as a collateralised borrowing, there is a risk that it will be treated as a loan from the issuer to the originator, and the mortgages considered as a part of the originator's estate in the event of its insolvency.

The term 'true sale' may sometimes be misleading, however, because a given transfer of mortgages may well be a sale for certain purposes, but not in other circumstances. For example, it has been argued that the criteria for establishing an accounting sale under generally accepted accounting principles[15] are more stringent than the criteria for establishing a sale under insolvency law.[16]

14 S L Schwarcz, 'Structured Finance: The New Way to Securitise Assets' (1990) 11 *Cardozo Law Review* 607, 608.

15 In a transfer of mortgages to the SPV, the originator would expect the transfer to constitute a sale for accounting purposes. That way the financing is reflected on its balance sheets as a sale of assets, and not as a secured loan (which would increase leverage). The originator also may want the transfer to be a sale if its mortgage origination deed restricts the originator's ability to incur debt or pledge its assets. The deed may provide that accounting terms such as 'debt', when used in the deed, must be

It is possible for a court to conclude that the real intent of the transaction was not to legally or equitably transfer the mortgages to the trustee issuer, but was a financial (credit) transaction masquerading as a securitisation. This approach is variously referred to in the literature as a 'substance over

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construed in accordance with the Australian Accounting Standards. Whether a given transfer of mortgages violates the terms of the deed, however, is a legal question that turns closely on the precise language of the instrument.

The Accounting Standards Board (U.K.) Application *Note on Securitisation* (FRS 5) requires the following tests to be applied to determine whether the mortgages has effectively been sold by an originator to an SPV for accounting purposes:

> the transfer must not contravene the terms and conditions of the underlying mortgages;
>
> the originator must have no residual beneficial interest in the principal amount of the mortgages, and the issuing vehicle must have no formal recourse to the originator for losses;
>
> the originator must be under no obligation at any time to repurchase the mortgages;
>
> the arrangements for the transfer must be such that, if mortgages are re-scheduled or re-negotiated, the issuing vehicle and not the originator must be subject to the revised terms.

If any of these tests are not satisfied, the transaction must be accounted for as a secured loan rather than as a sale. In this case, the mortgages must be retained on the individual balance sheet of the originator, and the originator must also record a liability for any amounts received in respect of the purported sale. For more detail, see J Lindsay and C Thomson, 'Tax and Accounting Issues' in D C Gardner (ed) *Securitization* (1997) 24. As noted earlier, these tests have been incorporated into the *Australian Prudential Standards* - APS 120 for capital adequacy purposes.

In a U.S. context, the relevant accounting standard is SFAS 77 – *Accounting for Receivables Sold with Recourse*. The accounting principles for securitisations are also currently set out in the U.S. Financial Accounting Standard Board Statement No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishment of Liabilities* (FASB 140) (2000); Accounting Standards Board (U.K.*) Application Note on Securitisation* (FRS 5); International Accounting Standards Committee, *Accounting for Financial Instruments* (IAS 32); Australian Accounting Standard Board, Urgent Issues Group (UIG – 28) *Consolidation of SPV* (1999) which is based on IAS 32. For a detailed discussion of accounting issues for securitisation, see I Plater, 'Accounting and Tax for Off-Balance Sheet Financing' *IIR Conference*, Sydney, September 1992, 6-12; C. Wheeler, 'Accounting Aspects of Securitisation' in C. Stone et al (ed), *Asset Securitisation Theory and Practice in Europe* (1991) Chapter 40; A Davies, 'Critical Accounting Issues for Financial Institutions and Financial Instruments' (1991) 105(5) *Australian Banker (Melbourne)* 276.

From January 2005, Australian, United Kingdom, United States and other international accounting standards will officially converge: AASB, 'AASB Adoption of IASB Standards by 2005', August 2004 http://www.aasb.com.au. While a detailed discussion of accounting issues is plainly beyond the scope of this article, a brief account of some of the principles laid down by the courts in relation to whether a 'true sale' has occurred is given below, and these are relevant for the accounting treatment of RMBSs.

16 V Kothari, *Securitisation: The Financial Instrument of the New Millennium* (2003), 224-225; S L Schwarcz, *Structured Finance: A Guide to the Securitization of Assets* (2nd ed, 1993), 28-30; J Cunningham and G Engel, *Asset Based Financing Including Securitisation and Acquisition Financing* (1991), 487-488.

form' approach, or a 're-characterisation'.[17] The courts take the view that, as a matter of law, the label attaching to a transaction is not conclusive, and can be departed from where the court considers that the true character of the transaction differs from that by which it has been described. Having said this, the courts do construe the transaction in its entirety, accustomed as they are to honouring the language of an instrument and generally refusing to go behind that language if its meaning is clear.[18]

In evaluating the substance (as opposed to the mere form) of the transaction, the term 'true sale' is most often used in analysing whether the transfer of mortgage loans has effectively removed the mortgages from the originator for insolvency-remoteness purposes.[19] If the originator becomes insolvent and the mortgages are no longer owned by the originator, but instead are owned by the trustee (or security trustee) of the SPV, then the SPV would also own the rights to the repayments on those mortgage loans. Assuming the repayments were made and the trustee-issuer had priced its issue profitably, the SPV would have sufficient cash to pay its RMBSs without defaulting. However, if the transfer were held *not* to be a sale for insolvency purposes, it would be deemed an advance of funds by the SPV to the originator, secured by the mortgages. The SPV would then be a creditor of the originator and have a security interest, but not an (equitable) ownership interest, in the mortgages. Further, if the originator becomes insolvent, the SPV might not be able to collect sufficient repayments on the initial housing loans to pay the interest and principal it owes the investors in its RMBSs.

The United Kingdom

Overseas, the courts have held in a number of cases that particular securitisations of loan receivables should be 're-characterised' as collateralised borrowings. For example, in *Re Curtain Dream plc*[20], a so-called 'sale' of assets was held in fact to be a secured loan arrangement. For a transaction to be re-characterised in this way by a court, it is not

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[17] See generally V Kothari, ibid, Chapter 7; Standard & Poor's, *Structured Finance Australia and New Zealand* (1999) 77, 86; S I Glover, 'Structured Finance Goes Chapter 11: Asset Securitization by Reorganising Companies' (1992) 47 *Business Lawyer* 611, 621 - 623; T Frankel, *Securitization: Structured Financing, Financial Asset Pools, and Asset-Backed Securities* (1991), paragraphs 7.21 - 7.22. This 'substance over form' approach is fairly common in taxation law and the interpretation of accounting standards.

[18] S I Glover, ibid; I Plater, above n 15; M. J. Cohn, 'Asset Securitization: How Remote is Bankruptcy Remote?' (1998) 26 (4) *Hofstra Law Review* 929.

[19] The insolvency issues have been discussed in detail in Chapter 7 of the author's PhD thesis. See above n 7.

[20] [1990] BCLC 925.

necessary that the parties' agreement should be shown to be a sham intended to mask their true agreement. Rather, it is sufficient that the agreement does not fall into the legal category into which the parties have sought to place it.[21]

In *Re George Inglefield Ltd*,[22] the English Court of Appeal emphasised that, in determining the true nature of a securitisation transaction, consideration must be given to the whole of the agreement, bearing in mind the essential differences that exist between secured loans and sales. The key differences between a sale and a loan secured by way of mortgage or charge, as explained by the Court of Appeal in *George Inglefield* case were:[23]

- In a 'true sale' transaction, the vendor is not entitled to get back the subject matter of the sale by returning the purchase price. However, in the case of a mortgage or charge, the mortgagor is entitled, until foreclosure, to get back the subject matter of the mortgage or charge, by repaying the loan to the mortgagee;
- In a 'true sale', if a purchaser sells the subject matter of the purchase, and realises a profit, he does not have to account to the vendor for that profit. However, in the case of a mortgage or charge, if a mortgagee realises the subject matter of the mortgage for a sum of more than is sufficient to repay it, it must to account to the mortgagor for the surplus;
- In a 'true sale', if a purchaser were to resell the property she had just purchased, at a price that was less than the price she paid to the vendor, she would not be entitled to recover the balance from the vendor. However, in the case of a mortgage or charge, if a mortgagee realises the mortgaged property for a sum that is insufficient to repay it the money that it has paid to the mortgagor (by way of the loan), the mortgagee is entitled to recover the balance of that money from the mortgagor.

The courts in some cases have not always followed the above criteria. For example, in several cases, transactions have been upheld as 'true' sales of book debts, even though there were personal obligations on the vendors to make good to the purchasers any default in payment by the debtors.[24]

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21 *Welsh Development Agency v Export Finance Co Ltd* [1992] BCLC 148.

22 [1933] 1 Ch 1(CA). For further discussion, see C Wheeler, above n 15, 535, 540-541; P L Mancini, 'Bankruptcy and the UCC as Applied to Securitization: Characterizing a Mortgage Loan Transfer as a Sale or a Secured Loan' (1993) 73 *Boston University Law Review* 873.

23 *Re George Inglefield Ltd,* 27-28. On the facts of that case, the transfer of assets was regarded as 'true sale'. See also, V Kothari, above n 16, 278.

24 See, for example, *Olds Discount Co Ltd v John Playfair Ltd* [1938] 3 All ER 275, referred to in *Welsh Development Agency v Export Finance Co Ltd* [1990] BCC 393.

Moreover, in *Orion Finance v Crown Financial Management,*[25] the Court reviewed the tests in *George Inglefield* and held that none of the three conditions could, by itself, destroy the characterisation of a transaction as a 'true sale'. The Court held:

> No single one of these features may be determinative. The absence of any right in the transferor to recover the property transfer inconsistent with the transaction being by way of security; but its existence may be inferred, and its presence may not be conclusive. The transaction may take the form of a sale with an option to repurchase, and this is not to be equated with a right of redemption merely because the repurchase price is calculated with reference to the original sale price together with the interest since the date of the sale. On the other hand, the presence of a right of recourse by the transferee against the transferor to recover a shortfall may be inconsistent with a sale; but it is not necessarily so, and its absence is not conclusive. A security may be without recourse. Moreover, the nature of the property may be such that it is impossible or at least very unlikely that it will be realised at either a profit or loss. Many financing arrangements possess this feature. The fact that the transferee may have to make adjustments and payments to the transferor after the debts have been got in from the debtors does not prevent the transaction from being by way of a sale.[26]

The problem with the *Orion Finance* decision is that, taken *in vacuuo*, it adopts a 'neither this, nor that' approach, and offers no real guidance to the courts, legal scholars or practitioners advising on RMBS issues. On the particular facts of the case, the relevant agreement expressly recorded that the transfer of assets was for security purposes, and was construed as such. However, in not providing more concrete guidelines, while at the same time arguably reversing previous decisions on point, the *Orion Finance* decision would appear to be a retrograde step unless it can be limited to its facts. The consequence is that, in the UK at least, scholars and practitioners must await a case coming before the House of Lords to definitively decide the issue. Perhaps fortunately for Australian practitioners, the decision is of only persuasive influence in this jurisdiction.[27]

25 [1996] 2 BCLC 78.

26 [1996] 2 BCLC 78, 82.

27 It has been argued that the approach of the courts contrasts sharply to the approach that was taken in UK Accounting Standards Board's statement - FRS 5 *Accounting for Securitisation*. In the first place, it is argued that the criteria specified in FRS 5 do not coincide with those that have been discussed by the courts in determining the true character of a transaction. For example, there is no reference in the case law to the question of whether or not the transaction is in accordance with the terms and conditions of the assets transferred. Furthermore, under FRS 5, a transaction that fails to satisfy any of the specified criteria fails to qualify as a sale for accounting purposes, and there is no flexibility in this respect. For further discussion, see J Lindsay and C Thomson, 'Accounting and Tax Issues', (1997) 20; M Raines and G Wong, 'Aspects

Canada

The recent Canadian decision of *Metropolitan Toronto Police Widows and Orphans Fund v Telus Communication Inc*[28] is similar in approach to that of the earlier English courts' decisions, in that it provides some guidance as to whether an RMBS program involves a 'true sale' or merely a secured loan transaction. The court laid down the criteria to be considered when deciding whether an originator had actually achieved a genuine sale of assets to the SPV. In deciding that the transaction was a 'true sale', the Court looked to four main factors: the intention of the parties; the wording of the contract – in particular, the contract contained no references to a loan, security, or the repayment of principal or interest on a loan; the conduct of the parties; and whether it in BC Tel's interest to structure the transaction as a sale or a secured loan.[29]

The United States

In contrast, the position adopted by the US courts in the oft-cited decision of *Major's Furniture Mart v Castle Credit Corp*[30] is that the parties' intention is not, at least in the United States, a primary factor in determining whether a securitisation transaction involves a 'true sale' or a secured loan. In that case, the respondent argued that the language of the agreement expressly referred only to sales and purchases and, on that basis, the parties did not intend to effect a security transfer. The court responded that it was not bound by the nomenclature that the parties applied to their relationship. The nature of the agreement is properly governed by the business activities of the parties. The court emphasised the fact that there was full recourse to the seller, and noted the following elements of recourse provided by the plaintiff, Major's Furniture Mart:

- the plaintiff retained all conceivable risks of not being able to collect on these accounts;
- the plaintiff warranted that the customers met the criteria set forth by the defendant;

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of Securitization of Future Cash Flows Under English and New York Law' (2002) 12(2) *Duke Journal of Comparative and International Law* 453.

28 [2003] OJ No 128 (ONSC). In that case, BC Tel (the predecessor to Telus Communication) used the proceeds of a securitisation transaction entered into between BC Tel and the RAC Trust (an SPV) to redeem a series of bonds. The plaintiff argued that, for every \$100 of principal, the redemption of the bonds cost \$115 and the redemption price paid by BC Tel pursuant to the trust deed was approximately \$103, resulting in a substantial loss to bondholders of \$12. The bonds were not set to mature until 2005. The defendant argued that BC Tel did not in fact sell the receivables to the RAC Trust.

29 [2003] OJ No 128 (ONSC) paragraphs [40-41].

30 602 F 2d 538 (3rd Cir 1979).

- the plaintiff performed credit checks to ensure that the criteria were met;
- the plaintiff guaranteed that the accounts were fully collectible;
- the plaintiff was to indemnify out of the a reserve account for losses sustained due to customer default; and
- the plaintiff was to repurchase any account that remained in default for more than 60 days.[31]

In the circumstances, it was held that the true nature of the transaction was such that the legal rights and economic consequences of the agreement bore a greater similarity to a collateralised borrowing than to a 'true sale'.

The Court adopted a similar economic, as opposed to an intention-based, approach to the question of true sale in *Endico Potatoes Inc v CIT Group Factoring Inc.*[32] In particular, the Court focused on the level of risk transferred to the purchaser. In a sale or assignment of loan receivables, there is always a risk that the obligor — the initial borrower in this context — will not pay. The Court held that if this risk was not fully and finally transferred to the SPV, a true sale had not occurred and the transaction was, in effect, a secured loan.

In adhering to this strict view (which, incidentally, is the same as that adopted by APRA for Australian capital adequacy purposes), it will be noted that this US decision is at variance with some of the English and Canadian authorities, which have held that even full recourse back to the originator is not incompatible with a concept of a legal sale.[33]

Summary of Overseas Decisions

Although various courts have considered whether a given transfer of loan receivables constitutes a sale or a secured loan for insolvency purposes, the facts of the decided cases have not, for the most part, been representative of modern mortgage securitisation transactions. The English courts and those of the British Commonwealth are, as a matter of common law tradition, more inclined to honour the expressed intention of

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31 602 F 2d 538 (3rd Cir 1979). See also V Kothari, above n 16, 227. A similar approach was adopted in *Re Evergreen Valley Resort* 23 BR 659 (1982).

32 67 F3d 1063 (1995).

33 [2003] OJ No 128 (ONSC) paragraphs [50-51]. Indeed, in the English decision of *Welsh Development Agency* discussed earlier, the Court found that although no real risk had passed from the seller to the purchaser, the transaction was nonetheless one of sale. Dillon LJ in that case emphasised that there was no clear touchstone for determining whether an agreement is really a sale or a secured transaction. For further discussion, see S L Schwarcz, *Structured Finance* (1993), 28. In addition, see the Canadian decision of *Metropolitan Toronto Police Widows and Orphans Fund v Telus Communication Inc* [2003] OJ No 128 (ONSC).

the parties than to read an implied intention into the circumstances. However, the U.S. courts have delivered several decisions ignoring the body of an agreement and regarding a securitisation program as a financial transaction (ie essentially, as a secured loan). Accordingly, the cases are not easily harmonised, and which factors are relevant and which should be given greater weight are open to interpretation. This uncertainty in the judicial treatment prompted some to quip that a court could flip a coin, and find support in the case law for either characterisation – 'true sale' or secured loan.[34]

Australia

There has been no case law to date in Australia that deals with whether a purported sale in a securitisation transaction (or, more specifically, an RMBS program) will be re-characterised as a secured loan.

However, it is possible to meaningfully comment on what would constitute a 'true sale' in Australia by reference to the Australian corporations law, which, of course, incorporates the Australian accounting standards.[35] In Australia, the use of a trust structure in mortgage securitisations facilitates an off-balance sheet treatment for accounting purposes, where the trustee company is not related to or a subsidiary of the originator. It is therefore important when structuring a RMBS transaction that an off-balance sheet trustee (more usually, a trustee company) be established as the SPV, where the originator cannot be seen to hold a majority interest in the trustee company for the purposes of the Australian accounting standard on consolidation.[36]

In the present context, this standard would require the mortgage originator to not hold any ownership interest in the SPV (or vice versa). It posits two key tests for determining a consolidation, namely (a) whether the entity operates as part of another economic entity,[37] and (b) who *controls* the entity. 'Control' is defined in AASB 1024 as 'the

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34 R D Aicher and W J Fellerhoff, 'Characterisation of a Transfer of Receivables as a Sale of a Secured Loan Upon Bankruptcy of the Transferor' (1991) 65 *American Banking Law Journal* 181, 183. For further discussion on the preconditions for a 'true sale' of mortgage assets, see T E Plank, 'The True Sale of Loans and the Role of Recourse' (1991) 14 *George Mason University Law Review* 287, 315; M Oates, 'RBA Guidelines on Funds Management and Securitisation' (1994) 10(3) *Australian Banking Law Bulletin* 23.

35 See Pt. 2M.5 of the *Corporations Act* 2001 (Cth).

36 Australian Accounting Standard, AASB 1024, *Consolidated Accounts*, May 1992, paragraphs xxi –xxiii. See also, APRA, *Disclosure and Separation*, Guidance Note AGN 120.1, (September 2000) paragraph 11: 'An ADI should not have any ownership or beneficial interest in a SPV or control the SPV such that it would need to be consolidated in accordance with Australian Accounting Standards'.

37 For a detailed discussion see AASB 1024, paragraphs xxv and xxvi.

capacity of an entity to dominate decision making, directly or indirectly, in relation to the financial and operating policies of another entity … '.[38] Accordingly, at least so far as AASB 1024 is concerned, the question of control depends on substance rather than form. Insofar as the accounting standards form part of the Australian corporations law, it is arguable that the Australian courts would also adopt a 'substance over form' view of whether an RMBS transaction is a 'true sale', or a secured loan.

Assignment of the Originating Mortgagee's Rights to the SPV

Under general law there are two methods by which a debt or other chose in action may be assigned: legal assignment and equitable assignment.[39] In Australian RMBS programs, the originating mortgagee's rights are invariably assigned in equity to the SPV. Commercially, there are good reasons for this.

An assignment, whether legal or equitable, operates under general law to transfer a proprietary interest in the asset in question. To be valid at law, an assignment of mortgagee rights to the SPV would need to be (i) absolute - ie not by way of a charge only; (ii) in writing, (iii) for the whole of the debt; and (iv) notified expressly in writing to the debtor.[40] Any assignment that did not satisfy all four criteria would generally be given effect as an equitable assignment, but not a legal one.[41]

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38 See I Plater, above n 15, 12.

39 Contractual rights, being choses in action as opposed to things in possession, were not assignable at common law without the consent of both parties to the original contract. The courts of equity, however, did give effect to assignments of choses in action. Perhaps the most significant feature of the division between the common law and equity was the almost complete refusal by the courts of law to recognize equitable rights, titles and interests. Each system, law and equity, devised its own procedural rules and remedies, resulting in substantive differences in the approaches of the two jurisdictions. For a discussion of the divisions between, and subsequent fusion of, the courts of common law and equity, see R P Meagher, W Gummow and J Lehane, *Equity Doctrines and Remedies* (1992), 36–41.

40 *Jones v Humphrey* [1902] 1 KB 10; *Forster v Baker* [1910] 2 K B 636 (CA); *In Re Steel Wing Co. Ltd.* [1921] 2 Ch 349. A legal assignment operates from the date on which notice is given to the underlying debtor to transfer (i) the legal right to the debt; (ii) the legal and other remedies for the same; and (iii) the power for the assignee to give a good discharge for the debt without the concurrence of the assignor. For more detail, see H Saban, *Corporate Debt Securitisation* (1994) 42; M Ono, 'Unique Aspects of Japanese Securitization Relating to the Assignment of Financial Assets: A Comment on Raines and Wong' (2002) 12 (2) *Duke Journal of Comparative and International Law* 469.

41 See sections 199-200 of the *Property Law Act* 1974 (Qld). Difficult and unresolved issues may arise as to whether consideration is necessary for the effectiveness of an equitable assignment. However, a detailed discussion of these issues is not only beyond the scope of this article, but would be entirely moot since, in an RMBS context, the SPV as equitable assignee does provide consideration: it pays the

The most common way to effect the assignment is by way of a deed of assignment which, by virtue of section 199 of the *Property Law Act 1974* (Qld), must comply with all of the requirements for a legal assignment of a debt, and is subject to all existing equities having priority claim over the rights of the assignor.[42]

Any assignment transfers only rights and not obligations.[43] It is not possible to 'assign' obligations without obtaining the consent of the debtor – notwithstanding the frequency with which the rule is misunderstood.[44] In the context of a mortgage securitisation, therefore, it is only the originating mortgagee's rights[45] under the residential mortgage that are capable of assignment.

There are, however, practical problems with using a legal assignment. First, a legal assignment accompanied by notice effectively removes the originator (assignor) from the transaction, as the mortgage and the mortgagee's rights become vested in the trustee-issuer (assignee), with direct recourse to the borrower.

Second, a legal assignment deals with the transfer of an 'entire loan', as there is no legal basis at law for a legal or absolute transfer of *part* of a loan.[46] Thus, a legal assignment cannot transfer any obligation for the trustee-issuer to provide further funds in a loan facility where the loan has not yet been fully drawn down by the borrower.

Third, to be recognised at law, express notice of the assignment would need to be given to the initial borrower. One of the fundamental reasons

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originating mortgagee a sum equal to the present value of the mortgagee's rights and obligations.

42 See also *Newfoundland Government v Newfoundland Rly Co* (1888) 13 App Cas 199 (PC); *Smith v Parks* (1852) 16 Beav 115; *Re Tout and Finch Ltd* [1954] 1 All ER 127; [1954] 1 WLR 178; and *Halsbury's Laws of Australia*, Vol 6 (4th ed) paragraph 67.

43 Thereby effecting a novation. In the context of securitisation, a novation involves a tripartite arrangement whereby the two parties to an original contract, the originator and the debtor, agree with an SPV that the SPV shall become a substitute for the originator, and thus assume the originator's rights and obligations under that contract and in the creation of a new contract between the SPV and the debtor.

44 See *Tolhurst v Associated Portland Cement Manufacturers Ltd* [1902] 2 KB 660, 668 (CA). Neither at law nor in equity could the burden of a contract be shifted from the shoulders of a contractor onto those of another, without the consent of the contractee: per Lord Collins MR. In an Australian context, see also B E Salter, *An Overview of the Legal Issues Relevant to Securitisation in Australia* (2000), 5.

45 Strictly, it is the mortgagee's 'rights, title and interest' which are assigned.

46 *Encyclopaedia of Forms and Precedents*, Vol 4 (1938), 566. This is the case in all Australian jurisdictions except Western Australia: see section 20(3) of the *Property Law Act* 1969 (WA). In the other Australian jurisdictions, however, an assignment of part of a loan is recognised in equity: see *Williams v Atlantic Assurance Co* [1933] 1 KB 81 and *Re Steel Wing Co* [1921] 1 Ch 349.

why mortgages are generally assigned to the SPV in equity[47], but not law, is precisely because the mortgage originator has a commercial incentive not to make its customers aware of the securitisation of their assets.[48]

An equitable assignment has positive advantages for a mortgage originator wishing to securitise its mortgage interests, which in part mirror the disadvantages of a legal assignment.[49] An equitable assignment must still be in writing,[50] and there must be evidence that the originator as assignor intends to immediately and irrevocably transfer its interest to the SPV as assignee – usually by deed,[51] although a letter has been held to be sufficient.[52] Importantly, however, notice need not be given to the initial borrowers that their mortgages have been assigned, for the assignment to nevertheless be effective in equity, as between the originator and the SPV.[53]

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47 Standard & Poor's, *Structured Finance Australia and New Zealand* (1999) 40; B Taylor, 'Assignments of Securities in Corporate Re-Financing' (1998) 13 *Australian Banking and Finance Law Bulletin* 141.

48 In some jurisdictions, the giving of notice to the underlying mortgagors will be a necessary formality in the transfer of mortgages. In most European systems, for example, the Spanish Civil Code makes compulsory a notice to the debtor in order to effect the transfer. Similarly, in France, Luxembourg, Italy, Japan and South Korea, the giving of notice to the debtor is a formal requirement: J Borrows, 'Legal and Regulatory Issues' in D C Gardner (ed), *Securitization*, (1997), 15; P R Wood, *Title Finance Derivatives, Securitisation, Set-Off and Netting* (1995), 53.

49 An equitable assignment will operate to transfer only the beneficial interest in the asset, and legal title will remain with the assignor: *Holroyd v Marshall* 11 Eng Rep 999; and *Howard v Miller* (1915) App Cas 318. Like a legal or absolute assignment, an equitable assignment does not operate to transfer obligations from the originator to the issuer. An equitable assignment will, however, transfer all rights of the originator in the loan or part thereof to the issuer, since a transfer of part of a right or chose in action is permissible under an equitable assignment: see *Jones v Humphreys* [1902] 1 KB 10 and *Williams v Atlantic Assurance Co Ltd* [1933] 1 KB 81. This in effect gives the SPV/assignee recourse to the borrower in equity, albeit only to the extent of the beneficial interest in that part of the loan assigned, and only when the originator/assignor (or the owner of the legal title) is joined as a party to a claim. See *Derham Bros v Robertson* [1898] 1 Q B 765; *William Brandt's Son & Co v Dunlop Rubber Co Ltd* [1905] App Cas 454; L B Klein, 'Legal Issues Relating to Participation in Bank Loans', in J Lederman (ed), *The Commercial Loan Resale Market* (1991) 357, 385. Issues relating to sub-participations are not discussed here, as they are beyond the scope of this article.

50 The assignment of equitable interests has historically been regulated by statute. For example, section 9 of the *Statute of Frauds* 1677 required all 'grants and assignments' inter vivos of 'any trust or confidence' to be in writing, signed by the assignor. For any assignment to be valid, it had to be in writing from the beginning. See H A J Ford and W A Lee *Principles of the Law of Trusts* (2004), Chapter 3.

51 *Norman v Federal Commissioner of Taxation* (1963) 109 CLR 9, 29.

52 *Re Ward* (1984) 55 ALR 395.

53 This is not to say that notice of the assignment to the debtor is unimportant. It could be highly significant in at least two situations in practice - first, where there are competing assignments of the same mortgage. Second, where the borrower purports to pay off his

The Problem of Notice

As explained earlier, not giving notice to home loan borrowers that the mortgagee rights to their loans have been assigned, potentially exacerbates a moral hazard problem and may have implications for economic efficiency. In purely legal terms, however, neglecting (or worse still, deliberately failing) to notify borrowers of a risk that their houses could be sold through no fault of their own, would seem at the least to be unconscionable.[54] As Kirby P (as he then was) poignantly put it in *Canham v Australian Guarantee Corporation Ltd*:

> The ultimate theory behind the philosophy of truth in lending...is that disclosure ... will help to ensure honesty and integrity in the relationship (where one party is normally disadvantaged and even vulnerable); promote informed choices by consumers; and allow the market for financial services to operate effectively.[55]

Moreover, there are other potential problems if borrowers are not given notice that their mortgages have been assigned.[56] While not informing borrowers of the assignments may be expedient for the banks, it is contrary to the conventional wisdom on mortgage transfers. For instance, according to at least one leading text:

> [T]he transfer of a mortgage is an unsafe investment, unless the mortgagor concurs or joins in the transfer as a party to the transaction ... if a transferee makes the initial mistake of not obtaining the concurrence of the mortgagor, it is vital that notice of the transfer should at once be given. [57]

In normal circumstances, it is prudent for a transferee, whether legal or equitable, of a mortgage to give notice to the borrower that the mortgage has been transferred. The main risk, if notice is not given, is that the mortgagor might continue to make payments to the assignor/originator,

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or her loan to the assignor/originator, unaware that its mortgagee rights have been assigned, and obtaining the originator's purported discharge of the debt: *Stocks v Dobson* 43 Eng Rep 411 (Ch App 1853). If a borrower were to pay the originator, which then became insolvent immediately after receiving the payment but prior to paying the SPV, the SPV would have no recourse against the debtor: see R Derham, *Set-Off* (1996); P R Wood, *Title Finance, Derivatives, Set-Off, and Netting* (1995). The SPV would then need either to claim that the originator received the payment in trust for the SPV, or claim against the originator's estate, in common with other creditors. (This might occur, for example, if the SPV was unable to establish a proprietary right to the payment received, or trace its proprietary interest in the payment into the hands of the originator).

54 Indeed, there would seem to be an appreciable future risk of litigation against the banks, IMPs and/or sponsors for contravention of the 'unconscionable conduct' provisions of the *Trade Practices Act* 1974 (Cth).

55 (1993) 31 NSWLR 246, 254; and (1993) ASC 56-227, 58354.

56 These potential problems tend to exist in all common and civil law jurisdictions. See generally, P R Wood, *Title Finance, Derivatives, Securitisations, Set-Off and Netting* (1995), 52-53.

57 E F Cousins and I Clarke, *The Law of Mortgages* (2001), 384-386.

and the mortgagor cannot be obliged to pay again in the event the originator fails to remit those payments to the SPV.[58] In practice, this problem is often overcome by paying the mortgage borrowers' repayments directly into the trustee-issuer's bank account, so that they do not pass through the originator's hands.[59] However, while it is possible for computer systems to be programmed so as to divert standing orders and direct debits to the appropriate account, this arrangement could not of course be implemented in respect of mortgage payments made by cheque, without informing borrowers in some sense (even if only by virtue of the account details on their bank statements).[60]

In addition, the failure to notify the borrower of the assignment may permit the borrower to set off claims that he or she has against the originator, against obligations he or she owes to the originator. Under general law, an assignee (legal or equitable) takes 'subject to equities' which means, in effect, that the SPV/assignee should be in no better position vis-à-vis the debtor than the originator/assignor was prior to the assignment.[61] Once the SPV/assignee notifies the borrower of the assignments, any future right to set-off will be lost because, under general law, once notice of assignment has been given, the debtor cannot do anything to take away or diminish the rights of the assignee as they stood at the time of the notice.[62] Set-off rights will continue to exist and be binding on the assignee, however, to the extent that they arise out of the same contract that gives rise to the loan asset.[63]

Set-off rights are fundamentally important to bank or assignment programs, for two reasons. First, because banks are deposit-taking

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58 *Williams v Sorrell (*1799) 4 Ves 389, 31 ER 198; *Norrsh v Marshall* (1821) 5 Madd 475, 56 ER 977 [1814] All ER Rep 587; *Re Lord Southampton's Estate* (1880) 16 Ch D 178; *Parker v Jackson* [1936] 2 All ER 281.

59 Macquarie Securitisation Ltd, *Master Information Memorandum, PUMA Fund P-12* (2006), 58-59.

60 The lack of notice to borrowers also exposes the banks to the risk of litigation. Nor should the banks be unaware of this risk. For example, the foreign currency lawsuits of the early 1990s were largely a result of management in the major banks failing to inform their borrowers of the potential risks involved in non-traditional borrowing. See for example, *Clenae Pty Ltd & Ors v ANZ Banking Group Ltd* [1999] VSCA 35 (9 April 1999); *David Securities Ltd & Ors v Commonwealth Bank & Ors*, unreported, Full Federal Court, per Lockhart, Beaumont and Gummow JJ, 10 May 1990; and at first instance in the Federal Court of Australia per Hill J, 11 May 1989; *Chiarabaglio v Westpac Banking Corporation* (1989) ATPR 40-971; and *Leitch & Ors v Natwest Australia Bank Ltd & Anor*, (unreported, 12 October 1995, Federal Court of Australia) per Cooper J.

61 *Dawson v Great Northern & City Railway Co* [1905] 1 KB 260 (CA 1904); and *Re Harry Simpson & Co* (1964) NSWLR 603, 605.

62 *Roxburghe v Cox* 17 Ch D 520, 526 (CA 1881); and R Derham, above n 53.

63 *Business Computers Ltd v Anglo African Leasing Ltd* [1977] 1 WLR 578 (Ch).

institutions, some borrowers will also maintain deposit or trading accounts with their lenders, and may therefore be entitled to set off their deposits against their debt obligations to the bank.[64] Once the SPV/assignee has given notice to the borrower of its interest in the loan,[65] the borrower will lose any future right to set off deposits, but will retain any rights or equities accrued up to the date on which he or she received notice.[66] Second, if a bank has extended a mortgage loan to the borrower and the bank fails to honour that commitment, any damages that the borrower incurs as a result of the bank's failure may be set-off against the borrower's loan obligation.[67]

The risk of an SPV not receiving all of the anticipated income because of a right of set-off exercised by a mortgagor against the original mortgage lender can be minimised by a provision in the originator's mortgage documentation. Typically, this takes a form whereby each mortgagor agrees not to exercise any right of set-off he or she may have against the originator under general law.[68] Such an agreement would generally be valid until such time as a mortgagor became insolvent. The operation of insolvency set-off might then result in the reduction of the trustee-issuer's income in respect of a particular mortgage.[69]

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64 For a detailed discussion, see M Wormell, 'Securitisation and Set-Off' (1998) 9 *Journal of Banking and Finance Law and Practice* 181.

65 Or, for example, in the context of US law, once contractual privity is established between the borrower and the SPV.

66 *Diesel Motors Co v Kaye* 345 NYS 2d 870, 875 (1973); S Schwarz, *Securitisation and Structured Finance* (1993), 30-31; T Frankel, *Securitization: Structured Financing, Financial Asset Pools, and Asset-Backed Securities* (1991), para 7.23.

67 *Government of Newfoundland v Newfoundland Railway* Co 13 App Cas 199 (PC 1888).

68 J Borrows, above n 48, 15.

69 See generally, R Derham, above n 53; and P R Wood, *Title Finance, Derivatives, Set-Off, and Netting* (1995). Because of the competing claims which could arise and which could be set off against each other, it is clearly prudent for mortgages in favour of the originator's employees to be excluded from the pool of mortgages that make up the backing for an issue of RMBS. The same argument can be made for the exclusion of mortgages in favour of persons who are depositors with the originator. However, an originator that is authorised to take deposits (eg a bank or building society) might find it difficult to implement this, especially if its general policy is only to grant mortgages in favour of its own depositors. Moreover, a mortgagor who is originally unconnected to the originator, might become one of its employees or depositors. When considering the seriousness of this risk arising from the operation of equities, however, it is important to bear in mind that equities exercisable by individual mortgagors are likely to give rise only to isolated problems in specific cases. Since such isolated incidents are unlikely to undermine the value of the trustee-issuer's earnings to any significant extent, they can therefore be viewed as being of relatively limited importance in practice.

Avenues for the SPV to enforce its Rights other than as Equitable Mortgagee

Suing on the Debt

Commercially speaking, like any secured loan, a housing loan is comprised of two elements: (i) a personal contract for payment of the debt; and (ii) an interest in the debtor's property as security for the payment of the debt. Both are normally transferred together in equity in an RMBS program.

However, in a RMBS program,[70] the SPV's proprietary interest may be lost if the trustee-issuer permits a commingling of its own funds with those of the originating bank.[71] In such a case, if the SPV's proprietary interest is lost, any dispute between the SPV and the originating bank will need to be resolved on the basis of the debtor-creditor relationship.

Suing for Breach of Trust[72]

Under an equitable assignment, either the originator or the security trustee holds the legal title to the residential mortgages on trust for the trustee-issuer. This trust extends to all rights and claims, including accrued interest, arising out of the mortgages.[73] If the originator were to fail to remit funds to the issuer, it would be in breach of trust as well as in breach of its contractual obligations under the terms on which the mortgages were sold.

The claim for breach of trust could be significant in the event of the originator becoming insolvent, as the trustee-issuer might then be able to trace the money that should have been transmitted to it so as to obtain satisfaction of its claim in priority to the originator's unsecured

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70 There would appear to be more scope for this to occur in an RMBS program where the trustee-issuer is essentially a subsidiary or other entity related to the originating bank.

71 Standard & Poor's, *Structured Finance in Australia and New Zealand* (1999) 73.

72 It is interesting that, as discussed earlier, in Australian RMBS programs, the originator's mortgagee rights are assigned in equity to an SPV. In this way, the originator as the holder of a legal (and initially equitable) interest in residential mortgages purports to vest an equitable interest in those mortgages in the SPV by assignment. However, purely from the perspective of trust law, the equitable interest could equally well be vested in the SPV by the originator, at law, making a declaration of trust. The difference between the two mechanisms would be that, while both would convey an equitable interest to the SPV, the equitable assignment would result in a constructive trust, whereas the declaration of trust would create an express trust. See H A J Ford and W A Lee, *Principles of the Law of Trusts* (2004) [3180]. The reason why most RMBS programs in Australia utilise the equitable assignment route, rather than an express trust, is that it is perceived to be simpler and less costly.

73 Standard & Poor's, *Structured Finance in Australia and New Zealand,* (1999) 73.

creditors.[74] The right to trace is lost if the trust property is so mixed with other property of the originator as to become untraceable and, in that situation, the issuer's only claim against the originator would be a personal claim for breach of trust.

Structuring the Special Purpose Vehicle

Australian RMBS programs typically structure the SPV as a unit trust that holds an equitable interest in the underlying residential mortgages on behalf of the unit holders as beneficiaries, and receives and disburses income through to the RMBS investors and unit holders. This unit trust structure typically involves the appointment of an established, independent trustee company to act as trustee.

The unit holders are typically subsidiaries of the bank or sponsor.[75] In most programs, the trust has separate classes of capital and income beneficiaries – ie those beneficiaries that hold units representing an interest in the capital of the trust, and those that hold units representing an interest in the net income of the trust up to a maximum of (for example) $1,000, after all interest and principal payments have been made to the RMBS investors.

The holders of capital units are entitled to a distribution of the corpus of the trust estate, if any remains, after all the obligations of the trustee to the creditors of the trust (eg the providers of support facilities to the trust) are met.[76] The holders of the income units are entitled to receive distributions of net trust income (if any) after the day-to-day expenses of the trust (such as interest obligations on the RMBSs, and fees and expenses) are met.

The trustee also generally acts as the issuer of the RMBSs. The investors in these RMBSs - typically institutional investors - rank as secured creditors of the unit trust. The trustee typically grants a charge over the mortgages of the trust to a security trustee, who agrees to hold that charge for the benefit of certain secured creditors. (eg the bond holders, or the interest rate risk manager). If the trust were to be wound up, the security trustee would be required to ensure that the assets of the trust were distributed according to the law governing corporate trustees.[77]

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74 See J Borrows, above n 68, 14; and B Taylor, 'Enforceability of Debt Securities Issued by Trustees in Securitisation Programs' (1998) 9 *Journal of Banking and Finance Law and Practice* 261.

75 See for example, Macquarie Securitisation Ltd, *Master Information Memorandum, PUMA Fund* P-12 (2006) 38.

76 *Ibid*, paragraph 4.6.

77 For further discussion, see Chapter 6 of the author's PhD thesis, above n 7.

Impact of the Consumer Credit Code

Since 1 November 1996, many of the housing loans taken out in Queensland have been regulated by the *Consumer Credit Code* (the Code),[78] which is actually an annexure to the *Credit (Queensland) Act* 1994 (Qld). Substantially similar Codes exist in all Australian States, although some differences do exist between States. The law in the State where the loan was taken out normally governs the term of the contract, even where the borrower moves interstate.[79]

For present purposes, the principal aspect of the Code that has caused concern in the industry has been whether the SPV, as well as the originator, may be classed as a 'credit provider', and whether the SPV is therefore subject to the responsibilities imposed on credit providers by the Code. These responsibilities include the provision of:

- full, pre-contractual disclosure to borrowers and guarantors of the details of credit contracts;[80]
- regular account statements and notices[81] (including notices of any changes in the interest rate, and account keeping fees and charges[82]) so that borrowers are aware of the current state of their loan accounts; and
- key rights to borrowers, such as –

  the right to negotiate a variation of loans up to $125,000 on the grounds of temporary hardship (e.g. illness, unemployment);[83]

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78 Certain provisions of the Code, such as those relating to court applications for a variation of credit terms based on hardship, do not apply to home loan contracts (credit contracts) with a maximum loan amount exceeding $125,000: section 66(3).

79 The Code, which is state-based legislation, was introduced across Australia on November 1, 1996. In the context of RMBS programs, the Code regulates mortgages for residential owner occupation executed after 1 November 1996, as well as mortgages containing continuing credit provisions (this includes revolving home equity loans) executed before 1 November 1996. It also regulates all contracts entered into by credit providers with individuals where the credit is wholly or predominantly for personal, domestic or household purposes, including all personal loans, overdrafts, credit card facilities, credit and debt facilities, consumer leases, consumer hire purchases and retail credit: see section 4. The majority of the financial assets that have been securitised in Australia to date have been residential real property mortgages and guarantees.

80 See particularly sections 14-15 of the Code.

81 See sections 31-34, and 58-64 of the Code.

82 See also A Duggan and E Lanyon, *Consumer Credit Law* (1999) Ch 11.

83 See sections 66-69 of the Code. Debtors who are unable to meet their repayment obligations because of substantial hardship caused by circumstances such as unemployment or illness may apply to the credit provider for extensions of time, or postponement or reduced payment arrangements. These provisions apply only if the debtors can reasonably expect to meet their obligations if these variations are granted. A debtor may apply to a court if the provider refuses to agree to a variation. This right is not available if the credit amount exceeds $125,000.

a right to apply to Court or a tribunal to reopen unjust transactions[84] and review unconscionable interest and other charges[85]; and

a right to protection against enforcement of unfair loan agreements by the lender.[86]

Plainly, across all borrowers in a mortgage pool, performing these statutory responsibilities involves significant costs. Moreover, failure by the credit provider to perform its responsibilities under the Code can involve civil[87] and criminal[88] liability, not only for itself, but also for any

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84 See sections 70-71. A debtor, mortgagor or guarantor may apply to a court for a determination on whether a credit contract is unjust: sections 70-73. If this is proven, the contract may be reopened and appropriate remedies granted. The meaning of 'unjust' is very wide. Under section 70(7), it includes 'unconscionable, harsh or oppressive' credit contracts, and could go further. For example, it is not inconceivable that a credit contract might be found to be unjust if it breaches the moral standards that the community expects from business operators. The Court must consider 'the public interest', and all the circumstances of the case, in a manner reminiscent of the factors considered under the unconscionability provisions of the *Trade Practices Act* 1974 (Cth). The Court also has wide powers to reopen an unjust transaction. Those orders include relieving the debtor or guarantor of his or her payment obligations.

Section 74 of the Code enables the Court to join as parties to proceedings, additional persons who have an interest in the profits of the mortgage or a beneficial interest in a mortgage, and to make orders affecting the persons if the court holds the mortgage to be unjust: *Crocco v Esanda Finance Co Ltd* (1993) ASC 56223. It is conceivable that, if the Court holds the residential loan contracts in an RMBS program to be unjust, the Court could join the trustee of the SPV as a party to the proceedings, and make an order concerning the trustee which, while not explicitly effecting, could indirectly impact adversely on the interests of bondholders in the sense that the trustee would seek indemnification from the trust fund. It is also conceivable that an originating lender might join the trustee of the SPV and seek a contribution from it for compensation payable. For further discussion, see generally T Robinson, *The Impact of the Code on Securitisation*, (1996) 90-91.

85 Section 72. In practice, an application fee is generally payable by the mortgagor to the Originator/Servicer. Section 72 of the Code empowers the Court, upon the application of a debtor or guarantor, to declare an establishment fee or charge to be unconscionable and annul or reduce the fee or charge. Section 72(3) provides: 'In determining whether an establishment fee or charge is unconscionable, the Court is to have regard to whether the amount of the fee or charge is equal to the credit provider's reasonable costs of determining an application for credit and the initial administrative costs of providing the credit or is equal to the credit provider's average reasonable costs of those things in respect of that class of contract.' While there is no formal definition of 'establishment fee or charge' in the Code, section 72(3) indicates that it is the fee imposed for determining the application, together with the initial administrative costs of providing credit. While section 72(3) does not strictly compel credit providers to ensure that their establishment fees or charges exceed the credit provider's costs, it plainly creates considerable incentive for the credit provider to do so when read together with the other provisions in section 72. Under these other provisions, credit providers who do not relate establishment fees to reasonable costs, run the risk of actions by debtors and guarantors for Court orders. Section 19 of the Code also gives the debtor the right to terminate the credit contract before credit has been provided.

86 See Part 5 of the Code.

87 A debtor or guarantor in a relevant residential mortgage loan may apply to Court regarding a possible breach of any of the key requirements of the Code: sections 100-

linked supplier[89] who is also deemed a 'credit provider' for the purposes of the Code.

Who is the Credit Provider in an RMBS Program?

The Code defines a 'credit provider' as 'a person that provides credit, and includes a prospective credit provider.'[90] 'Credit' is defined in the following terms:[91]

> For the purposes of this Code, 'credit' is provided if, under a contract:
>
> (a) payment of a debt owed by person (the debtor) to another (the credit provider) is deferred; or
>
> (b) one person (the debtor) incurs a deferred debt to another (the credit provider).[92]

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101. If the breach is proven, the credit provider may lose all the interest charges owing on the mortgage loan. Alternatively, if it is a continuing credit contract, the credit provider could lose all interest charges for the period ordered, which could be significant if the interest is compounded, for example, on a monthly basis. Where the debtor's or guarantor's loss is greater than the amount of outstanding interest charges, the credit provider may be ordered to pay compensation to the actual loss: sections 103, 107.

The extent of any civil liability might even depend upon who makes the application for the imposition of these civil consequences. If it is the debtor, then the size of the penalty can be significantly greater than that which would be the case if the credit provider or the 'State Consumer Agency' – ie in Queensland, the Office of Fair Trading – brought the application. The credit provider is subject to a maximum fine of $500,000 for each key contravention under the Code.

In terms of other forms of civil liability, Division 2 Pt 6 of the Code provides that a Court may order the credit provider to make restitution or pay compensation to any person affected by a contravention, other than one for which a civil penalty is specifically provided for in the Code. This could conceivably extend to securitised bondholders. In addition, a credit provider's failure to comply with certain requirements in connection with a mortgage or guarantee may result in the mortgage or guarantee (or particular provisions of those documents) being ordered void or unenforceable.

88 The commission an offence under the Code exposes the credit provider, and officers of a corporate credit provider who aid and abet the commission of that offence, to monetary penalties. The level of penalty varies with the contravention, but the maximum penalty currently provided for in the Code is $10,000.

89 In terms of the liability of such a linked credit provider, a credit provider may become 'linked' to a loan contract if a supplier of goods and services regularly refers its customers to that credit provider or has a contract, arrangement or understanding with the credit provider. For example, an agent for a bank often arranges home mortgage finance for clients of a building company, which sells house and land packages. The bank might be classified as a linked credit provider to the building company on the basis of these dealings. This linked credit provider might become liable under sections 117-118 for misrepresentations or breaches of contract by the supplier, if it is not commercially worthwhile to sue the supplier (eg because it is insolvent or in liquidation).

90 See Schedule 1 of the Code.

91 Section 4 of the Code.

Except in the case of IMPs who effectively act as spotters for the banks or larger mortgage providers,[93] in practice, virtually all mortgage originators[94] are credit providers under this definition, and are therefore subject to the responsibilities imposed on credit providers by the Code.

However, in the context of RMBS programs, once the originator's mortgagee rights have been assigned in equity to the SPV, the real question is whether, for the purposes of the Code, the credit provider is the originating lender or the trustee-issuer. This question is governed by section 166 of the Code. It provides that:

> (1) If the rights of a credit provider under a credit contract, mortgage or guarantee are assigned or pass by law to another person, this Code from then on applies to that other person, and does not impose any further obligation on the credit provider.
>
> (2) The debtor, mortgagor or guarantor has and may exercise the same rights in respect of the credit contract, mortgage or guarantee against the assignee as the debtor, mortgagor or guarantor has against the credit provider.
>
> (3) Subsection (1) does not apply while the credit provider continues to receive payments from the debtor...

Taken together, these provisions would seem to imply that, after their housing mortgage has been assigned in equity to an SPV, the borrowers/mortgagors would hypothetically have the same rights against the trustee-issuer (assignee) as they had against the originating bank or IMP (ie assignor)[95] who made the loan to them.[96]

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92 According to section 4(2), the amount of credit is the amount of the debt actually deferred, excluding interest and certain other charges under the contract.

93 In the case of those IMPs that effectively act as 'spotters' for the banks or larger mortgage providers, the initial lender, not the IMP, will normally be the credit provider for the purposes of the Code. After assignment, the issues relating to who is the relevant 'credit provider' for the purposes of the Code - ie the initial lender or the SPV - are the same as set out below.

94 For further discussion of the mechanics of mortgage origination, see, T Robinson, 'Securitisation Update' *Seventh Annual Credit Law Conference* (1997) 3.

95 Section 166(2); and T Robinson, 'Impact of the Code on Securitisation', (Clayton Utz, September 1996), 85. Borrowers/mortgagors would also acquire the usual rights under general law against the equitable assignee that result from equitable assignment: see R Meagher, W Gummow and J Lehane, above n 39, paragraphs 699, 6100, 6101; and A J Duggan, *Regulated Credit: The Sale Aspect* (1986) paragraph 12.32. For example, if the originating bank or IMP (assignor) imposed excessive charges on the mortgagor in contravention of sections 21 or 30 of the Code, the mortgagor would be able *ex facie* to assert a right to recover the amount of the excess from the SPV (assignee). Similarly, the mortgagor may potentially have rights, actionable directly against the SPV (as assignee), in respect of misrepresentations or misleading conduct by the originating bank or IMP, either at common law or under legislation such as the *Trade Practices Act* 1974 (Cth).

However, as noted earlier, in practice, notice of the assignment is not generally given to debtors. Borrowers would therefore not normally be aware that an assignment has taken place, and would continue to make repayments to their initial credit provider (the assignor). This would seem to imply[97] that the originating bank or IMP, rather than the SPV, remains the 'credit provider' for the purposes of the Code. This is, of course, a line of argument that the banks and sponsors of RMBS issues would have considerable incentive to employ, should any cases on point be litigated.[98]

At least for typical RMBS programs, the effect of section 166 would seem to be that the originating bank or IMP remains the credit provider so long as it continues to receive repayments from the mortgagors but, once that ceases, the trustee-issuer of the SPV should effectively become the credit provider, and assume the attendant responsibilities under the Code. However, the effect is more likely to be of intellectual curiosity than of practical significance since, if borrowers are never notified of the assignments to the SPV, they will in the normal course of events continue making repayments on their loans to their originating lender until the loans are paid off. After that point, there should, in general, be no practical concern with whether the SPV or the originator is the relevant 'credit provider' under the Code.

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96 In short, *ex facie*, they may sue the trustee-issuer of the SPV as assignee of the originating mortgagee's rights. By itself, section 166(1) is plainly a statutory gloss on the equitable rule that obligations cannot be assigned.

97 By virtue of section 166(3) of the Code.

98 A counter-argument is that, in this situation, while the borrowers are continuing to make post-assignment repayments to the bank or IMP as credit provider from the borrowers' perspective, the bank or IMP is receiving the repayments as *agent* from the SPV's (assignee's) perspective. However, the problem with this counter-argument is that the borrowers are not given notice of the assignment, so that the bank or IMP would appear to be acting as agent for an *undisclosed* principal. And, according to the doctrine of the undisclosed principal, it is arguable that the originating bank or IMP remains liable as the credit provider, not only on the basis of section 166(3), but also at common law. See for example, *Keighley, Maxsted & Co v Durant* [1901] AC 240, 261; *Vital Finance Corporation Pty Ltd v Taylor* (1993) ASC 56-205, 58,179-58,182; D W Greig and J L R Davis, *The Law of Contract* (1987) 1001-2; and S Fisher, *Agency Law* (2000), Chapter 10.

In any event, under the recently enacted section 169A,[99] the Code allows stakeholders to grant indemnities in respect of civil and criminal liability under the Code. As noted earlier, the trustee-issuer is in practical terms not responsible for compliance with the Code, and probably does not strictly need an indemnity against liability potentially arising under it. Nevertheless, a Court or tribunal order may still be made under section 74,[100] and it would be imprudent if trustees did not obtain an indemnity from the credit provider against such liability. Such indemnities are justified on the basis that, if they were not given, the trustee-issuer of the SPV would not be obtaining 'clean' mortgagee rights, for which it gave good consideration when those rights were assigned to it in equity. Not surprisingly, therefore, it is common not only for trustee-issuers (or their fund managers) to obtain such indemnities from originators,[101] but for originating banks or IMPs to obtain similar indemnities from their agents

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99 Section 169A was inserted into the Code by the *Consumer Credit Code Amendment Act* 1998. It provides that:

> An indemnity for any liability under this Code is not void, and cannot be declared void, on the grounds of public policy, despite any rule of law to the contrary.
>
> The liabilities to which this section applies include the following -
>
> > a liability for any criminal or civil penalty incurred by any person under this Code;
> >
> > a payment in settlement of a liability or alleged liability under this Code;
> >
> > a liability under another indemnity for any liability under this Code.
>
> This section is subject to section 169(2).
>
> This section does not derogate from any other rights and remedies that exist apart from this section.
>
> This section extends to any indemnity obtained before the commencement of this section.

In short, the section allows any stakeholder who is potentially liable under the Code to obtain an indemnity from another person, who may themselves in turn obtain an indemnity from anyone except the borrower or guarantor: section 169(2). In general, rights and remedies under general law are preserved. Section 169A(2) allows a credit provider to contract out of liability for a criminal penalty under the Code. At common law, such an agreement would be void as contrary to public policy, but section 169A(1) displaces this rule. It provides that an indemnity from any person for any liability under the Code is not void on the ground of public policy. The provision also validates indemnities obtained retrospectively.

100 See the foregoing discussion in relation to unjust loan contracts.

101 See for instance, in the context of Macquarie Bank's RMBS programs, see *Master Information Memorandum, PUMA Fund - P12* (2006) 46-47. Perhaps interestingly, the APRA does not regard this as a contravention of its prudential regulatory guidelines in relation to the assignment being a 'true sale', presumably because indemnities in respect of liability under the *Consumer Credit Code* are not regarded as granting the SPV recourse back to the originator in respect of its primary debt obligations (which is the main thrust of the prudential requirements).

or 'spotters'; for trustee-issuers to obtain indemnities from their fund managers, usually to a pre-specified limit,[102] and thereafter from the trust assets;[103] and for the security trustee to obtain indemnities from the trustee-issuer.

Prepayment of Housing Loans

Early payout, or 'prepayment', of loans by borrowers is one of the chief cash flow management problems that face any lender. Notwithstanding the age of information technology and financial engineering, prepayment still interferes significantly with a lender's operating budgets, since unexpected prepayments interfere with the timing and duration[104] of interest income, principal repayments and expenses which the lender has carefully scheduled and factored into its cash flow management algorithms.[105]

In the context of RMBS issues, the SPV, as equitable assignee of the originating mortgagee's rights, is in a similar position to that of the traditional lender when initial borrowers in the mortgage pool pay out their loans early. The normal way in which lenders deal with borrowers' prepayment of loans is to levy an early prepayment charge, which generally equates to the capitalised value of the estimated net interest and fees foregone.

Under the Code, the mortgagor-borrower or guarantor is not only entitled to pay out the loan contract at any time,[106] but is also entitled to make partial prepayments at any time and be given credit for them.[107] Like traditional lenders, RMBS program sponsors cannot prohibit prepayments ahead of time. As a solution, the RMBS program sponsors, like traditional lenders, impose fees upon partial prepayment as well as early payout.[108] This is permitted under the Code, which, however, regulates the level of the fees charged.[109]

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[102] For example, under the Management Deed of the Macquarie Securitisation Program PUMA Fund P-12, the Fund Manager has agreed to indemnify the trustee-issuer against any civil liability under the Code up to a maximum of $500,000: see *Master Information Memorandum, PUMA Fund-P12* (2006), 46.

[103] See for instance, *Master Information Memorandum, PUMA Fund-P12* (2006), 86-87.

[104] Duration in this context is defined, in a financial engineering sense, as a measure of the average time at which payments are made, weighted by the size of the payments: see B Hunt and C Terry *Financial Institutions and Markets* (2002) 192; and T Valentine, G Ford and R Copp, *Financial Markets and Institutions in Australia* (2003) 173-182.

[105] See for instance, T Valentine, G Ford and R Copp, ibid, Ch 7.

[106] Section 75(1) of the Code.

[107] Section 24 of the Code.

[108] A related issue is whether an early termination or prepayment fee can take into account not only the administrative costs of the SPV, but also of other parties such as the servicer. To the extent that these costs are generally reflected in those of the SPV

In practice, the amount of the fee will reflect the costs and loss of income associated with reinvestment of the prepaid principal from the date of prepayment to that of the final scheduled payment under the loan.[110] These costs and losses are generally also covered by mortgage insurance policies, in the event that the sponsor makes significant losses (eg because the prepaid principal cannot be reinvested at comparable rates).[111]

Other State Regulation

While they have similar objectives, the regulation and administration of each State *Consumer Credit Code* varies, resulting in potentially significant differences in the incidence of:

- stamp duty – eg stamp duty charged on re-financings of existing mortgages in the pool;
- land tax – eg on rental properties in the pool (principal places of residence are typically exempt from State land tax);[112]
- transaction taxes (eg State financial institutions duty[113]); and
- State government administration fees – eg fees imposed by State government departments for processing dutiable transactions.

Because of the differences between the *Consumer Credit Codes* across States, it has been suggested that any reform in the administration of the Codes should be handed over to a Commonwealth department, so that one agency can adopt a centralised, consistent approach to consumer credit regulation in Australia.[114] Alternatively (and some libertarians might argue, preferably), all States could co-operatively enact 'mirror' consumer credit legislation – for example, by interstate and

itself, the answer would appear to be in the affirmative, for reasons similar to those set out here.

109 Section 72(4) provides: 'For the purposes of this section, a fee or charge payable on early termination of the contract or a prepayment of an amount under the credit contract is unconscionable if and only if it appears to the Court that it exceeds a reasonable estimate of the credit provider's loss arising from the early termination or prepayment, including the credit provider's average reasonable administrative costs in respect of such a termination or prepayment.'

110 See for example, in the context of Macquarie Bank's PUMA Fund, *Master Information Memorandum, PUMA Fund-P12*, 61-64.

111 In fairness to the banks and other IMPs, home loan borrowers are often also entitled to redraw on previously prepaid principal amounts (generally without penalty): see for example, *Master Information Memorandum, PUMA Fund-P12* (2006) 56-57.

112 See for example, *Land Tax Act* 1915 (Qld).

113 Cf Bank Account Debits Tax is a Commonwealth tax and therefore is applied uniformly across all States. See the *Debits Tax Act* 1982 (Cth) sections 3-5, and 8-10.

114 See for example, J Wilkin, 'Need for Reform of the *Consumer Credit Code*' (1998) 14 *Australian Banking and Finance Law Bulletin*, 17.

Commonwealth agreement, similar to that underpinning the *Competition Policy Reform Acts* of each State.

Summary and Conclusions

There have been no cases on point in Australia on whether an RMBS program involves a 'true sale' of mortgagee rights or should be viewed in essence as a complicated secured loan, and the overseas decisions offer little (and, even then, somewhat conflicting) guidance. However, to the extent that the accounting standards form part of the Australian corporations law, it is arguable that the Australian courts would look to see whether, in substance and taking account of all of the circumstances of the case, the mortgage originator owns or controls the SPV, or vice versa. The expressed intention of the parties, as evidenced by the documentation surrounding the issue, is likely to be of lesser importance in the Courts' determination of the issues. Thus, merely calling the transaction a 'residential mortgage-backed securitisation' program is unlikely to be sufficient to make it one, if the overall transaction appears in substance to be a secured loan arrangement.

A crucial strategic issue for management in RMBS programs is whether there has been a 'true sale' of the mortgagee's rights to the SPV. As the relevant regulator, one of APRA's key concerns in relation to securitisation programs is whether sufficient risk and reward have been transferred from the originating bank to the SPV in order to justify a finding that a true sale of the mortgagee's rights has occurred. It will not be if, for example, the originating bank retains influence over the setting of interest rates, the way in which delinquent assets are followed up, or the right to share in any profits of the SPV; or if investors in the RMBSs have any recourse back to the originating bank.

If a 'true sale' has not been effected, the mortgaged loans unsuccessfully assigned will lose their off-balance sheet status, and will be re-characterised as normal on-balance sheet secured loans. This plainly has significant consequences for, amongst other things, the ADIs' capital adequacy and taxation obligations. As noted above, the APRA's task as the regulator is made more difficult by the fact that there is no Australian case on point, and the few cases that have been decided overseas are inconsistent.

The originating mortgagee's rights in Australian RMBS programs are invariably assigned to the SPV in equity, principally because an equitable assignment involves fewer formalities than a legal assignment. Provided the intention to assign is manifested in writing, there is no need for the originator or the SPV to notify initial borrowers that their mortgages have been assigned, in order for an equitable assignment to be valid. To the extent that this minimises costs, it tends to be consistent with the commercial interests of the originator and the SPV. Whether it is in the interests of housing loan borrowers, however, is open to question.[115]

The SPV in Australia is generally structured as a unit trust, whose beneficiaries hold units representing equitable interests in the underlying residential mortgages. The income from these mortgages (in the form of borrowers' repayments) is received by the SPV and disbursed to the RMBS investors, or bondholders. The excess income and corpus, if any exists, is ultimately distributed to the unit holders, who are generally subsidiaries of the program sponsor.

In terms of the *Consumer Credit Code*, the main issue for RMBS programs in Australia is whether the SPV as well as the originating lender are 'credit providers' under the Code, with all the attendant responsibilities, which that role implies. Despite the concern that the Code has aroused in the industry, its impact is more likely to be illusory than real. Since borrowers are practically never notified that their mortgages have been assigned to the SPV, they typically continue to make their loan repayments to their originating lender, until the loans are paid off. The Code seems to provide that, so long as this occurs, the SPV will not be regarded as the 'credit provider', thereby escaping liability unless a Court orders *ex post* that key aspects of the loan contract are unjust or unconscionable. However, even then, the Code allows the SPV to be indemnified in respect of such liability, and such indemnities are in practice a prerequisite to the equitable assignment occurring in the first place.

As part of the structure of an RMBS program, the mortgage originator's (eg lender's) rights are assigned, or sold at a price, to the SPV. This means that, assuming the assignment is comprehensive and effective, the lender is able to 'wash its hands' of any liability as a credit provider to the initial housing loan borrowers under the *Consumer Credit Code*, leaving all liability with the downstream SPV. Not surprisingly, in light of their experience with litigation, as with the foreign currency lawsuits of the early 1990s,[116] the major bank lenders in particular therefore face an incentive, other things being equal, to securitise their home loans using RMBS programs in this way.

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[115] This issue has been discussed in Chapter 8 of the author's PhD thesis in the above n 7.

[116] See for example, *Clenae Pty Ltd & Ors v ANZ Banking Group Ltd* [1999] VSCA 35 (9 April 1999); *Davids Securities Ltd & Ors v Commonwealth Bank & Ors*, (unreported, Full Federal Court, 10 May 1990) per Lockhart, Beaumont and Gummow JJ; the same case at first instance in the Federal Court of Australia per Hill J, 11 May 1989; *Chiarabaglio v Westpac Banking Corporation* (1989) ATPR 40-971; and *Leitch & Ors v Natwest Australia Bank Ltd & Anor*, (unreported, 12 October 1995, Federal Court of Australia) per Cooper J.

From a public interest perspective, there may also be a moral hazard problem[117] inherent in RMBS programs, in that ADIs may have an incentive to lend housing loans to their customers too easily, if they know they can assign their rights and responsibilities under the loans to an SPV and believe that, as a result, they will not be held responsible if downstream participants in the issue default or become insolvent. One useful avenue for future research would be an investigation of the extent of this problem and, if it needs to be rectified, the best means of doing so. If a significant moral hazard problem exists, it may be useful for government to legislate to compel ADIs to accept their 'fair share' of responsibility (eg in tortious actions) for failures of their RMBS programs.

In addition, while they have similar objectives, the regulation and administration of each State *Consumer Credit Code* vary, resulting in potentially significant difference in stamp duty and land tax, transaction taxes (eg financial institutions duty) and State government administration fees. To alleviate such disparities, which become significant when aggregated across all mortgages in the pool, it could be useful for all States to co-operatively enact mirror legislation on consumer credit, perhaps by interstate and Commonwealth agreement, in a manner similar to that underpinning the *Competition Policy Reform Acts* of each State.

117 See for example, *Locker and Woolf Ltd v Western Australian Insurance Co Ltd* [1936] 1 KB 408; and *Jester-Barnes v Licenses and General Insurance Co Ltd* (1939) 49 Ll L Rep 231.