NEW PRUDENTIAL GUIDELINES FOR BANKS

QUESTIONS AND ANSWERS

Comment - John Edwards (Linklaters & Paines, London):

I think there is, as John Astbury said, a feeling in the United Kingdom that the combination of regulatory activity both on a domestic and an international or supra-national level is reaching saturation point. The ability to interpret what the Bank of England is saying, the ability to apply what it is saying, to specific transactions, is becoming increasingly difficult.

This makes for a rather curious situation. A document like this, the October 1988 release, which is of critical importance both to banks and their advisers in structuring new transactions, achieves the quality of law in all but name. That is to say bankers and their legal advisers, both internal and external, pour over every word in an attempt to arrive at a solution for a particular transaction. However, in general the Bank prefers to deal with bankers rather than lawyers.

That in itself would not be too bad, but there is an additional feature, namely that many of these regulations are in effect a moving target. The Bank of England has over the last two years successively, in relation to subordinated term capital, then perpetual, and now mortgage securitisation, started off with a set of rules only to find that as they are put into practice, fine tuning amendments are needed.

On a more specific note I would like to raise two topics which occurred to me, having had the privilege of reading David's speech before he gave it. The first is the question of subordination trusts. David persuaded us, I think rightly, that subordination in its broadest sense was something that a liquidator could not or would not recognise, at least on the basis of UK precedent, even though there had been a couple of judgments which had indicated that contractual subordination was permissible.

My question to David is to what extent subordination trusts are utilised either in the domestic framework in Australia or in the international? I should say that I am aware that a number of Australian institutions have, under English law done subordinated debt issues and have utilised the English concept of the subordination trust. What interests me would be to know whether as a matter of Australian law a structure can be created whereby

the liquidator can pay a trustee on behalf of a pool of subordinated creditors, and would not have to concern himself with the fact that the trustee was then under a fiduciary obligation to hand back the proceeds of the amount paid by the liquidator to the ordinary creditors, until such time as the ordinary creditors have been fully satisfied.

Response - David Bruce:

Whether it be State law or Commonwealth law is something which the Federal Attorney-General would probably like to discover in relation to corporations legislation. It will be the Federal law and actually in one of the earlier drafts of the buy-back provisions there were draft provisions which would have clarified the position of subordination, that is contractual subordination, but they have disappeared from the latest draft. Sure, obviously internationally a trustee is used and the Law Debenture Company is nearly always used. In Australia I am aware of issues where there is no trustee, which are purely contractual, these are purely domestic issues.

Question - John Edwards (Linklaters & Paines, London):

Does that not give rise to a multiplicity of layers of subordinated creditors, one subordinated to the other, and the other to yet a third and so on, and how does a liquidator unscramble all that?

Response - David Bruce:

Well in my case I would try as much as I possibly can to keep every bit of subordination precisely the same so that we have one level of subordinated debt. Of course otherwise it would be a shambles.

Question - John Edwards (Linklaters & Paines, London):

But there has never been a case in the Australian courts where such a subordination, a multiplicity of layers has occurred.

Response - David Bruce:

I am not aware of any case where subordination as such has even hit a court in Australia. Also, of course, subordinated debtors fortunately have remained solvent.

Comment - John Edwards (Linklaters & Paines, London):

We have managed to reverse out of the view we took that the only way to achieve a legally binding subordination was by a subordination trust, when we ran into a problem under the law against perpetuities. We found it impossible to create a perpetual trust, but were able to arrive at the view with the benefit of eminent leading counsel that we were able to create contingent subordinations.

Comment - Chris Hollis (Chairman):

I think we are running out of time a little and as this very technical subject on which David has managed to enlighten us, is one on which there may be some questions from the members in attendance, I think they should be given the opportunity to raise them. I would not intend that questions be answered immediately, but following the mode of our previous Chairman, to take note of the questions and answer them en block at the end.

Question - John Edwards (Linklaters & Paines, London):

The second area which I found interesting - it is mentioned in the Annexure to David Bruce's paper but it is not one which he dwelt upon - was the treatment of securitisation by clearing banks. We have experience of this in the UK with special purpose vehicles funded by banks but which are themselves not banks, and which have issued series of securitised bond issues, that is issues secured on mortgages which have been transferred to them as a result of them purchasing those mortgages with the proceeds of the issue. Very soon we shall have car loan receivables securitisation and credit card receivables. The Bank of England has taken a cautious view with regard to the ability of clearing banks, notably the big four, to securitise mortgages. All four have for the last ten years been heavily engaged in the mortgage market in direct competition to the High Street Building Societies and there is every indication that they will become more active rather than less active, not because of securitisation but because it is a very profitable business. There has so far only been one bank securitised issue. However, it is likely that within the next two or three weeks there will be a major bank issue. It would interest me to know what the climate is in Australia for clearing bank securitisation of home loans.

Response - David Bruce:

We are obviously looking at securitisation. It is something which people have been working at for several years. It has not really got off the ground. Certainly I am aware that we are talking with the Reserve Bank on some of these aspects and the Reserve Bank are helpfully trying to develop their thinking on these matters. I think it will happen but to what extent securitisation will be an important aspect of our system as it is in the States, I really rather doubt. I have just got the feeling that it will not. Do you think it will in the UK?

Response - John Edwards (Linklaters & Paines, London):

I think it will, yes.

Comment - Chris Hollis:

I would make a comment on that one myself, certainly banks are considering the feasibility and possibility of it. It has a lot of appeal to bank group treasurers, but the sort of vehicle that can be used might present a bit of a problem which has not properly been overcome by any system of which I am yet aware in Australia. That is to how you honour the bank's obligation of confidentiality in regard to customers, including mortgagors, and have an effective assignment of the benefit of a mortgage. It has not, as I understand the position, been perceived wisdom in this country that a bank can simply assign the benefit of a mortgage because it might suit it. That no doubt will be overcome with the flexibility of the mental capacity of lawyers, but has not satisfactorily been overcome to my knowledge yet. I see that clock is winding away up there and I have about 55 seconds. But I really would like to give an opportunity for questions.

Questions - Doug Spence (Thynne McCartney, Brisbane):

One of the aspects of prudential supervision is this question of exposure by a bank, the bank being required to monitor large exposure to clients or groups of clients. If a bank was to fail to consult with the Reserve Bank on a particularly large and perhaps excessive exposure, what could the Reserve Bank do more than issuing a please explain?

Response - David Bruce:

I have not got the slightest idea. I have never heard of that occurring. Banks in Australia, being responsible bankers, do pay heed to what the Reserve Bank says. When we have an exposure which the Reserve Bank may regard as excessive they would certainly want to discuss it with us, they would want an explanation, but in my experience they are always satisfied with the explanations that have been given. I do not know. I mean obviously there are all sorts of draconian powers, but one cannot imagine that they would attempt to exercise those in those sorts of circumstances.

Comment - Chris Hollis:

If I could add a small comment to that. The most draconian of the powers is the absence of the power at the moment and the possibility that that which is achieved by suasion now the Reserve Bank might attempt to achieve by regulation. That is something the banks are very keen to avoid if they possibly can.

Question - Richard Osborne (Corrs, Melbourne):

As a point of information there was a question asked as to whether there is any securitisation credit card receivables. I know of one example in Australia where that securitisation was attempted. Needless to say it was fairly hard to sell.

Comment - Chris Hollis:

Thank you very much for your interest. I really am out of time and my next Chairman will castigate me if I do not do something about it. It intrigued me earlier in the piece as to how a subject as technical as this could be presented in a manner which would keep everybody awake and you obviously have been awake. I was concerned to see how our speakers might be able to introduce one or more of the standard panaceas for keeping people awake, that is sex, religion or politics. Well we were not able to bring in politics, we did not bring in religion, but I see that David managed to bring in sex - twice! So on that basis and in recognition of the precision of his paper, and the effort that went into preparing it, without any further ado I would like you to thank him, John Astbury and John Edwards for the contribution they have made on this subject. It is one which is going to become of increasing significance to lawyers who really want to assist their clients in structuring their financial requirements in the most cost effective means possible. Thank you ladies and gentlemen.