Project Evolve

"The creation of a reliable non-bank loan market to service corporates with outstanding debt in excess of $25m."

Problem:
Most of the financing for the Australian corporate sector has been run through bank balance sheets. Notably, the 4 Major Australian banks along with international competitors are the only reliable and scaled channel corporates can obtain debt financing. This has resulted in debt facilities that potentially meet bank constraints rather than being borrower focused.

Further, the bank capital constraints on corporate lending has made the return on capital low and led to banks efforts to reduce risk-weight exposure at a time when corporate Australia needs to consider expanding credit to assist economic growth. The attractive attribute for investment professionals is that the investment grade cross-over and sub-investment grade debt markets offer alpha versus passive funds due to asymmetry of information, noneconomic market participants and the volume of origination that is possible. There is mutual benefit across the industry in developing this market.

Development of a Market:
We need various constituents to build this market:

- **Loan Investors (Collateral Managers):** funds that are able to provide debt capital for 7+ years. Liquidity will either be provided by a secondary market or through structured credit solutions such as CLOs
- **Structured credit investors or leverage providers:** loan funds without gearing typically yield 3-5%, which is too low in absolute terms. Leverage can be provided by structured credit transactions
- **Loan origination:** bank partners will still own relationships with borrowers and provide loans to the non-bank market
- **Loan trading:** banks need to facilitate liquidity in the investment market
- **Loan Servicing:** banks can provide this as a service to the non-bank industry.
- **Securitisation and Distribution:** banks can facilitate the creation of this industry and provide investments to their institutional investor base.
- **Professional service:** Legal, accounting, administration and technology providers

The key part here is coordination across these potential market constituents to create an initial market with scale. Given the low liquidity in a new market, the desire to have liquidity transformation is high. Securitisation vehicles can provide such liquidity as well as increase the speed at which the market scales up through deconsolidation loan portfolios from the banking sector.

APRA Additional Constraints:
New Guidance on APS 120 that is an extension of the recently release APG 120 has made bank loan deconsolidation harder. This is due to the requirement that an Originating ADI does not retain more than 20% of the senior tranche in a securitisation.

The key part to this 20% cap is a new securitization product will now need to be broadly distributed across the market. We would like to coordinated the AAA distribution and ideally find non-bank participants in this space. Post-retirement superannuation investment appears to be a logical destination for high quality secured assets with substantial subordination. This may be in the form of an enhanced cash offering or collateral for annuity-like products.

Next Steps:
We are looking to expand the network of interest parties in this space and would like potential market participants to register at loans@woolar.com.au so that we can organise a first loan industry conference call towards the end of June.