



# **Housing Finance Affordability Coalition**

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*Submission to Council of Financial Regulators  
review of small bank competition and funding*

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# 1. RECOMMENDATIONS

The Housing Finance Affordability Coalition thanks the Council of Financial Regulators and the ACCC for the opportunity to make a submission to the inquiry announced by the Treasurer on 15 June 2024.

The founding members of our Coalition include leaders in the non-bank mortgage industry – AFG, Redzed, Athena and others – and our Coalition continues to grow with new members joining.

Our objective is to advocate for policies that will help address the housing affordability crisis.

## We recommend that:

**1** The Government adopt recommendation 34 of the House of Representatives Economic Committee’s report Better Competition, Better Prices. The report recommends that ‘the Government examine the merits of adopting a government-backed Residential Mortgage-Backed Securities (RMBS) scheme, taking into account the characteristics, and evaluation, of the Canadian RMBS model’.

**2** The Australian Office of Financial Management (AOFM), in conjunction with Housing Australia, be given a mandate and powers equivalent to the Canadian Mortgage and Housing Corporation (CMHC) to implement the Canadian public securitisation model in Australia, appropriately adjusted for the Australian market.

**3** The Australian Prudential Regulation Authority (APRA) undertake a thorough cost-benefit analysis of prudential standard APS120 to address the competitive distortions on non-bank lenders, as recommended by the Productivity Commission.



## 2. EXECUTIVE SUMMARY

### OUR COALITION URGES SWIFT AND COMPREHENSIVE ACTION TO TACKLE AUSTRALIA'S HOUSING AFFORDABILITY CRISIS.

Adopting the Canadian model of public securitisation, appropriately adjusted for the Australian market, will increase competition and enhance access to affordable housing finance for home buyers and builders. By implementing this model, it is possible to turn the dream of homeownership into a tangible reality for more Australians.



**Australian Home Borrowers are Paying \$35 Billion per Year in Excess Interest Payments on their Mortgages**

In the three years prior to the GFC, pricing for discounted variable owner-occupied loans averaged a 1.25% spread over the RBA cash rate. By 2023, that spread had widened to an average of 2.93%, meaning Australian borrowers were paying an excess spread of 1.68% over the RBA cash rate. This spread widened as the share of Australian housing credit provided by non-banks fell dramatically after the GFC. Across the \$2.1 trillion home loan market, this spread widening equates to Australian home borrowers paying a total of \$35 billion per year in excess interest payments on their mortgages.



**Canadian Model is Tried and Tested**

For the last 37 years, the Canadian program has increased competition in Canada's mortgage market by allowing smaller lenders to secure lower-cost funding through securitisation.



**Canadians Have More Affordable Mortgage Options**

The National Housing Securities (NHS) program was introduced in Canada in 1987 through amendments to the National Housing Act (NHA), aiming to enhance the competitiveness of the mortgage market and increase housing affordability.



**Canadian Taxpayers Earned \$1 Billion Last Year**

The Canadian Mortgage and Housing Corporation (CMHC) plays the primary role in administering the program. In 2023, CMHC earned over \$1 billion for the Canadian Government by selling mortgage insurance to home borrowers as part of the program.



### Vital Source of Funding for Non-Bank Mortgage Lenders

In Canada, securitisation now accounts for a remarkable **35%** of mortgages compared to less than **8%** in Australia. Notably, the NHS program is heavily relied upon by non-bank mortgage lenders, fulfilling approximately **80%** of their mortgage funding needs. Non-major banks source a substantial portion of their mortgage funding (**25%**) through the program, while Canada's major banks derive less than **5%** of their funding from the same source.



### Canadian home borrowers save \$870 million annually

According to the Bank of Canada (BoC), the Canadian government-backed RMBS program significantly reduces aggregate mortgage funding costs for Canadian home borrowers, with estimated annual savings of at least **\$870 million** compared to private securitisation options.



### A More Resilient Financial System

The broad adoption of the Canadian model in Australia will also lead to a stronger, more stable financial system and allow RMBS market participants to continue lending through severe market disruptions.

This will reduce the need for extraordinary government support, such as the temporary measures provided during the global financial crisis (GFC) in 2008 and the COVID-19 pandemic in 2020.

The Canadian model can be scaled up quickly during crisis to provide more funding and keep credit flowing to Australian home buyers and builders.

## **3. BIG FOUR BANKS DOMINANCE MAKES HOUSING FINANCE LESS AFFORDABLE**

### **3.1 Controlling Market Share:**

The Big Four banks have a controlling share of nearly **75%** of all mortgages, based on APRA data.

### **3.2 Government Guarantees are a Huge Competitive Advantage:**

Banks can raise cheap funding because of both explicit and implicit government guarantees – creating one of the most concentrated and profitable banking sectors in the world.

### **3.3 Regulatory Framework Favors Big Four Banks:**

Financial services is also one of the most regulated sectors in the economy and this framework skews capital and funding advantages towards the banks while undermining competition from other sources.

### **3.4 Taxpayers Are On The Hook for Support to Banks:**

The current bank-centred model is fragile, requiring massive taxpayer support of the banking system every decade or so when global crises occur. During such periods of market dislocation, the Big Four banks can rely on taxpayer funding.

For example, during the COVID-19 pandemic the RBA provided banks with **\$188 billion** under the Term Funding Facility. Non-bank lenders received no equivalent support.

### **3.5 Home Borrowers and Taxpayers Deserve a Better Deal:**

Australia must adopt a sector-neutral approach that puts all lenders on a level playing field.

In other markets globally, policymakers have designed funding flows into mortgage markets to facilitate greater competition - with consumers benefiting from lower mortgage rates and taxpayers less exposed.

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## 4. A SECTOR-NEUTRAL APPROACH IS NEEDED

It is time for action to increase competition to create a more affordable, sustainable and stable mortgage funding system.

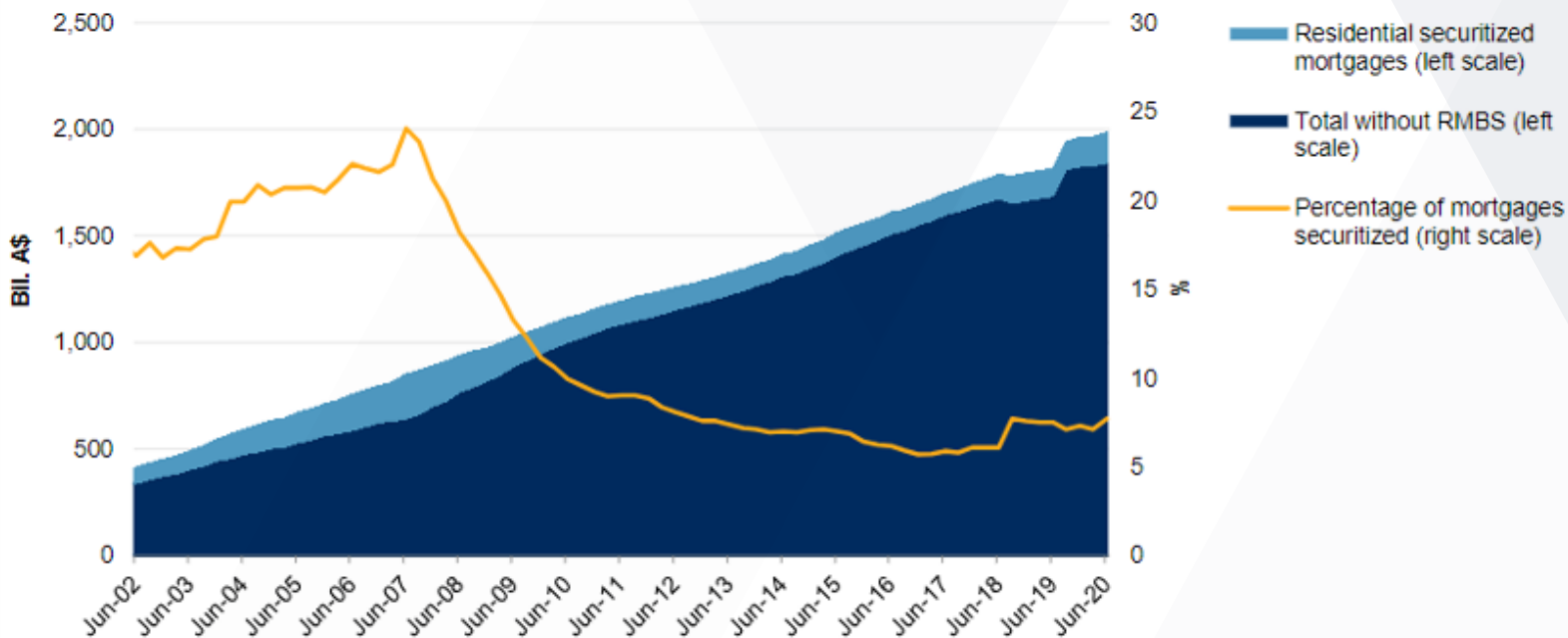
Our Coalition firmly believes that implementing a model similar to the Canadian model of public mortgage securitisation can achieve this in Australia. This innovative approach would not only reduce mortgage rates for homeowners and lower the cost of buying a home but could also provide access to borrowers previously locked out of the mortgage market and cheaper construction loans, thereby increasing the supply of affordable housing.

Before the onset of the GFC, smaller lenders relied on mortgage securitisation to offer affordable home loans. Mortgage securitisation transforms illiquid mortgages into tradable securities through the pooling of a group of mortgages. Those securities are issued to investors entitling them to income from the receipt of mortgage payments and are known as Residential Mortgage-Backed Securities (RMBS).

However, the Australian RMBS market was dislocated by the GFC – a declining share of mortgages are now funded by RMBS, as shown in [Exhibit 1](#).

### Exhibit 1

Value Of Australian Housing Finance And Securitized Mortgages



Source: Australian Bureau of Statistics.

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In stark contrast, Canada still funds **35%** of its home loans through RMBS, with smaller lenders utilising cheaper funding from issuing RMBS backed by the Canadian Government, under the National Housing Act.

In Australia, the emergence of the RMBS market prior to the GFC was a key driver of competition in the mortgage market, driving down borrowing cost for home buyers relative to the RBA cash rate. However, the dislocation of the Australian RMBS market during the GFC unwound the significant competitive pressure that increased RMBS issuance had been putting on industry profit margins for home loans.

The Australian RMBS market has historically been more stringently regulated than the US mortgage market. Australian lenders did not engage in the risky lending practices seen in the US pre GFC.

No rated Australian RMBS has ever suffered a permanent loss of capital, despite a series of global and regional shocks – the COVID-19 pandemic, the GFC, the early-2000s dotcom crash and the 1997-98 Asian Financial Crisis. However, even high-quality AAA-rated Australian RMBS issuance could not escape the ‘brand damage’ done to RMBS globally by risky subprime lending in the U.S.

Further, Australia’s regulatory response in successive crises has facilitated bank dominance. **Exhibit 2** illustrates how massive government liquidity support has been heavily skewed towards the banks and enabled banks to widen their mortgage rate spread above the RBA cash rate.

Australia’s bank-centred crisis toolkit has shaped a bank-centred financial system. In markets like Canada, public securitisation programs mean the government could efficiently intervene via capital markets during crises and avoid destroying competition in the process.

While the AOFM’s intervention stabilised the Australian RMBS market during the GFC, even some 15 years later new RMBS issuance remains a fraction of its pre-2008 levels, which has allowed the banks’ mortgage lending profit margins to once again expand, at the expense of Australian home buyers and home builders.

Without RMBS as a reliable, additional funding channel, the Australian banking system is without a critical pillar of stability and competition. The financial system has fewer funding options to fall back on during periods of global instability, making it more vulnerable to financial shocks.

Under the current bank-focused framework, regulatory interventions during global crises significantly erode competition and create additional costs for Australian home borrowers.

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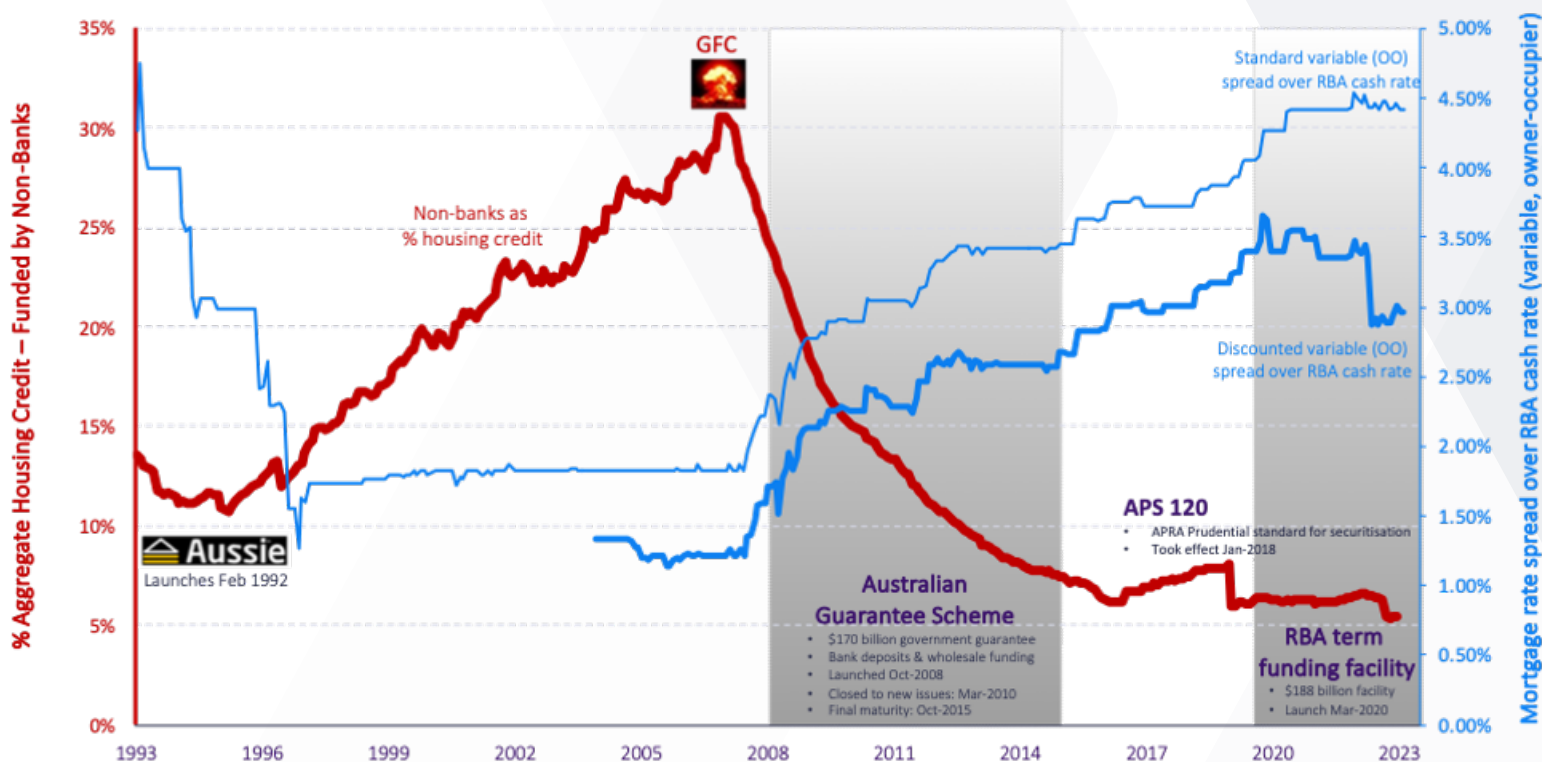
## 5. THE COST TO AUSTRALIAN HOME BORROWERS

The reduction in Australian securitisation has dramatically limited the availability of affordable housing finance from smaller lenders, leaving a lasting impact on the Australian housing market. Household borrowers and home builders have suffered from less competition and higher borrowing costs over and above the cash rate.

In the three years prior to the GFC, pricing for discounted variable owner-occupied loans averaged a **1.25%** spread over the RBA cash rate. By 2023, that spread had widened to an average of **2.93%**, meaning Australian borrowers were paying an excess spread of **1.68%** over the RBA cash rate. **Exhibit 2** shows how this spread widened as the share of Australian housing credit provided by non-banks fell dramatically after the GFC. Across the **\$2.1 trillion** home loan market, this spread widening equates to Australian home borrowers paying a total of **\$35 billion** per year in excess interest payments on their mortgages.

### Exhibit 2

Australian Mortgage Market: Non-bank Competition (LHS) & Mortgage Pricing (RHS)



Source: Non-bank housing credit (RBA – table D2 and D5); Mortgage rate spread over cash (RBA – table F5 and F1)

Higher borrowing costs for smaller lenders like non-banks has limited their ability to innovate products for borrowers who do not qualify for a bank mortgage at a competitive interest rate, effectively locking out a large part of the borrower market from accessing funding.

Some lenders that issue RMBS do not require mortgage insurance. Instead, the issuer puts hard credit support into those deals to protect investors, rather than relying on external mortgage insurers. This helps open the market to borrowers that would find mortgage insurance a prohibitor to entering the mortgage market.

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***Australian home borrowers are paying \$35 billion per year in excess interest payments on their mortgages***



## 6. THE CANADIAN MODEL

The Canadian public securitisation program serves as a reliable funding source for affordable housing finance.

In Canada, smaller lenders rely heavily on the public program for financial support. The program promotes competition in mortgage lending by offering cost-effective funding to small lenders that face limited access to alternative sources.

True competition promotes innovation which ultimately benefits the consumer (including those consumers wishing to enter the housing market).

Our Coalition encourages Australian policymakers to consider the following significant benefits of the Canadian public RMBS model:

### 6.1 Reduced Mortgage Rates:

The Canadian program has increased competition in Canada's mortgage market by allowing smaller lenders to secure lower-cost funding through securitisation.

This competition has resulted in lower mortgage rates for borrowers, making homeownership more affordable, and home construction more commercially viable.

### 6.2 Dedicated Funding for Social Housing:

Loans made for social housing are packaged and sold as RMBS, providing a valuable funding stream for housing for lower-income Canadians.

### 6.3 Attracting More Investors:

Canadian Government guarantees attract a diverse range of domestic and international investors to buy RMBS, which is, in essence, a 'government security.'

This would effectively address the prevailing challenge in Australia of limited investor capacity for domestic RMBS. It also overcomes the limited feasibility of foreign issuance since the GFC due to the elevated capital costs of conducting swaps. Prior to the GFC, foreign issuance supported most of the growth in Australian RMBS issuance.

Overall, these changes would enhance access to funding for smaller lenders in Australia by increasing the range of investors who would be attracted to buying RMBS. For example, government-backed RMBS would provide an important alternative investment opportunity for Australia's super funds.

### 6.4 More Resilient Financial System:

The Canadian program strengthens the solvency of the financial system by providing an additional liquidity source for housing finance.

Some RMBS issuance is held by banks, and the government guarantee provides a zero-risk rating for capital adequacy purposes, meaning banks don't need to hold capital against these RMBS.

Government-backed RMBS are also eligible for immediate repurchase agreements (repo) with the Bank of Canada to provide liquidity and are eligible as liquid assets under the Liquidity Coverage Ratio (LCR).

## **6.5 Stronger Economy:**

The Canadian program helps create a more stable, lower-cost mortgage market with a steadier supply of credit supporting housing construction activity, work for homebuilders, and jobs for tradespeople and apprentices.

## **6.6 Taxpayer Protection:**

The Canadian Government insures RMBS issuance on a 'zero risk' basis to cover any losses on the underlying mortgage portfolio, which is also guaranteed at the level of the individual mortgage.

The Canadian Government's role in backstopping systemic risk for RMBS is comparable to the Australian Government's existing guarantee of deposits up to \$250,000 under the Financial Claims Scheme (FCS).

The Canadian program has been in place for **37 years** without any claim on the guarantee reserve funds ever occurring, underscoring the soundness of the Canadian program.

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*Prior to the GFC, non-bank competition drove some Australians' mortgage rates down by nearly 1.70%-points compared to the RBA cash rate.*



## 7. THE OPPORTUNITY FOR AUSTRALIA

### 7.1 Boost Mortgage Competition:

To make housing finance more affordable in Australia, the Federal Government should consider adopting a public RMBS model based on Canada's NHS program, appropriately adjusted for the Australian market.

This would lead to lower mortgage rates by reducing the cost of mortgage funding, intensifying market contestability and helping promote product innovation.

### 7.2 Safe, Liquid Investments:

An increasing share of Australia's \$3.9 trillion superannuation savings could be safely channelled into affordable and sustainable housing finance by investing in government-guaranteed RMBS securities.

This becomes even more important as the super system expands and a significant portion of super savings transition into the retirement income stage where safer and more liquid fixed-income investments are required.

### 7.3 AOFM Experience:

To facilitate the program, the mandate of the Australian Office of Financial Management (AOFM) could be expanded to include responsibilities like those held by the CMHC.

The AOFM has significant experience with RMBS as an asset class. During the GFC, the AOFM's prudent investment in AAA-rated RMBS ensured the mortgage market continued to function and generated significant returns for taxpayers. The AOFM should consult regularly with Housing Australia to maximise funding for social and affordable housing.

### 7.4 Tailored to Australia:

The Canadian public RMBS model serves only as a template. Australia should adopt a similar framework, but with parameters tailored to our unique circumstances.

- A public securitisation program in Australia could allow borrowers to contribute less than 20% equity, which would help unlock financing for first home owners and borrowers whose savings have been outpaced by the significant increases in house prices.
- Australia could also broaden access to lower-income borrowers by integrating state and federal government shared-equity programs that lower the deposit requirement.
- There is a strong reliance on lenders in Australia to ensure a borrower can afford a loan and often many borrowers do not have the savings for a deposit of 20%. Some lenders do not require mortgage insurance which unlocks finance for many borrowers who do not have a sufficient deposit, but can service the mortgage. The Australian program should include these type of mortgages that do not require mortgage insurance.
- An Australian program should be further extended to other borrowers that fall outside the mortgage insurance criteria, with below-perfect credit histories, and those in need of financing with low or alternative documentation requirements.

These adjustments are of critical importance at a time when the Big Four banks have an inability or unwillingness to lend to such borrowers. The framework would therefore support access to finance for these types of borrowers without needing to weaken responsible lending obligations as some industry participants have proposed.

These modifications would ensure that the new public securitisation program offers fairness and opportunity to all in our community, long hallmarks of Australian society.

## **7.5 A Truly Contestable Market:**

Overall, the introduction of public securitisation as a lower-cost, flexible funding source for smaller lending institutions in Australia would level the playing field and give them the capacity to truly contest the mortgage market and do so sustainably.

The Big Four banks currently dictate the level of ‘contestability’ in Australia’s mortgage market. This was starkly demonstrated by three major banks recently cutting term deposit rates to fund lower mortgage rates – but only for new customers and not for their existing customers who are struggling under the weight of higher interest rates. This demonstrates that the Big Four banks can dictate contestability in the market.

Put simply, competition still happens on the Big Four’s terms. If smaller lenders had the same level of flexibility in their funding costs, they could truly contest the market.

The bold and long overdue structural change we are advocating for would make housing finance more accessible and affordable for borrowers and help increase the supply of affordable housing across Australia.

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## 8. PILOT PROGRAM

The Housing Finance Affordability Coalition proposes that the Australian Government implement a pilot program to assess the feasibility and effectiveness of a Canadian-style public RMBS program in the Australian context.

A pilot would allow the Government to test the program's viability in a controlled environment, gathering valuable data and insights to potentially inform the development of a nationwide program that promotes affordable housing finance and strengthens the financial system.

### 8.1 POTENTIAL TERMS OF A PILOT PROGRAM:

- **\$4-5bn program size**
  - **Consider how to limit the scope during the pilot period**
    - Whether facility is allocated according to:
      - a maximum of \$500 million per issuer on 'first-come, first-served' basis, or
      - issuer bids that are scaled back pro-rata if there is oversubscription
    - Maturity
    - Fee level
    - Floating only (for simplicity during pilot)
  - **Administration and Oversight**
    - AOFM to administer the program
    - CFR/ACCC taskforce to oversee the program and analyse the data to monitor the effectiveness of the pilot
  - **Risk mitigation**
    - All publicly guaranteed RMBS are AAA-rated
-

# APPENDIX

## PRODUCTIVITY COMMISSION RECOMMENDS REVIEW OF PRUDENTIAL STANDARD APS 120

In 2018, the Productivity Commission (PC) assessed APRA's prudential standard, APS 120, which regulates financial institutions' ability to hold RMBS. The PC found that modifications to this standard are essential to address its overly restrictive nature, which hinders sufficient affordable financing for housing.

The PC advocates for a more flexible approach to facilitate accessible financing for non-bank mortgage lenders. Revisions made to APS 120 in 2018 have resulted in higher funding costs for non-bank lenders. This is due to major banks being required to hold more capital when providing temporary 'warehouse' finance which allows non-banks to finance mortgage lending until they can package loans into RMBS for sale to investors.

The PC recommends a review of APS 120 before applying it to non-bank lenders. APRA should conduct a thorough cost-benefit analysis, including assessing the negative consequences on non-bank lenders' ability to compete with major banks and provide affordable housing finance.

## CANADIAN PUBLIC SECURITISATION MODEL



Source: FTSE Russell, for illustrative purposes only.

## ▪ THE STRUCTURE AND BENEFITS OF THE RMBS PROGRAM ARE DESCRIBED BY THE BOC:

### ▪ PROGRAM STRUCTURE:

- The program facilitates the issuance of RMBS by financial institutions. These RMBS are backed by pools of residential mortgages. The timely payment of interest and principal to investors is guaranteed by the Government through CMHC. This guarantee, paid for by the mortgage issuer via a guarantee fee, enhances the demand for the securities. Investors are relieved of credit risk and are assured of timely cash flows.

## ▪ **UNDERLYING MORTGAGES:**

- The underlying mortgages must also be insured by an approved A-rated mortgage insurer (paid for by the home borrower). All mortgages must have a matched interest rate basis to the NHS-RMBS being issued, with a minimum pool size of C\$2 million. Mortgage lenders who utilise the scheme must be approved.
- Mortgage insurance can be provided by CMHC or private insurers. In both cases, the Canadian Government guarantees the insurance. CMHC mortgage insurance has a 100% public guarantee, while private insurance has a 90% government guarantee. The government guarantee for private insurance becomes active if the insurer fails to honour its commitment to the mortgage issuer.

## ▪ **CANADA MORTGAGE BONDS:**

Mortgage issuers sell RMBS to the Canada Housing Trust (CHT), managed by CMHC. CHT funds its purchases by issuing Canada Mortgage Bonds (CMB) to investors. CMBs offer investors a timely payment guarantee, with the fee paid in advance by the mortgage issuer.

## ▪ **TWO-STEP APPROACH:**

1. The NHS-eligible originator pool is guaranteed by the Canadian Government to create an NHS RMBS that can be held on balance sheet or sold.

Banks often prefer to hold NHS RMBS as ‘zero-risk-weighted’ assets (meaning the bank is not required to hold additional capital) that also serve as ‘liquid’ securities because the Bank of Canada will accept them as collateral when it lends to banks. These liquid assets can be held on a banks’ balance sheets, funded by deposits in a capital-efficient manner.

Overall, only a portion of NHS RMBS are repackaged into CMBs.

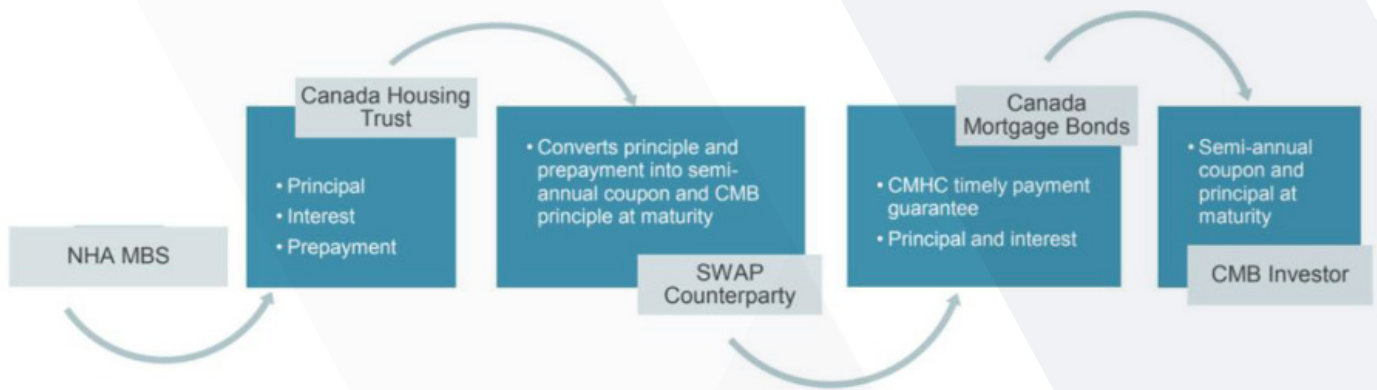
2. CMBs are created by repackaging originator NHS into ‘bullet’ maturity bonds. Unlike RMBS, the CMB program converts monthly amortising cash flows into typical bond-like payments, such as semi-annual or quarterly coupon payments and a final full principal payment.

These bonds are included in fixed income indexes and are sought after by fixed income investors. Typically, CMBs are issued at the same fixed income maturities as government bonds (in Canadian dollars and other currencies) to facilitate better pricing and liquidity.

## ▪ **BENEFITS OF GOVERNMENT GUARANTEE:**

The Canadian Government's timely payment guarantee effectively makes both CMBs and RMBS ‘government securities’ from a credit perspective, enhancing their attractiveness to investors. Nearly half of CMB investors are money managers, such as pension funds and insurance companies.

# CANADA MORTGAGE BOND STRUCTURE



Source: FTSE Russell, for illustrative purposes only.

- **FEES PAID BY LENDERS PROTECT TAXPAYERS AND PROMOTE COMPETITION:** Fees paid by bank and non-bank RMBS issuers for access to the government guarantee go into a reserve, which could cover taxpayers should there be any call on the guarantee. Since the creation of the program, this has never happened.

The program is off balance sheet and only a contingent liability for the Canadian Government due to the expected zero-loss risk retention by the Government on the guarantee of NHS/CMB.

## ▪ ISSUANCE LIMITS AND FEE LEVELS

- The CMHC has set limits and fees for its securitisation guarantee program.
- Starting in March 2025, the maximum amount of securitisation guarantee-in-force will be **\$600 billion**.
  - The Minister of Finance can also set yearly limits on new guarantees to manage housing market risks and the government's exposure to the housing sector.
- The CMHC will provide up to **\$60 billion** of new guarantees for CMBs and up to **\$170 billion** of new guarantees for RMBS annually.
- The guarantee fee is paid by the issuer (i.e. the mortgage lender) and ranges from **0.08%** to **3.15%** depending on the size and term of the issuance.
  - Canada's Big 6 Banks are discouraged from raising a large amount of funding under the program because the issuance of larger volumes attracts higher fees.
  - Once annual issuance by any lender exceeds C\$9 billion, the guarantee fee increases by nearly 3 times.
- There is a discounted fee of **0.05%** to **0.68%** (depending on the term of issuance) for affordability-linked mortgage pools, including social housing and multi-family housing.
- Approved issuers include banks, non-banks, credit unions, life insurance companies and dealers.

- Approved issuers must have a net worth of at least **\$3 million** and retain **2%** of the principal amount of RMBS outstanding, ensuring the issuer has ‘skin in the game’ (i.e. the issuer continues to have economic exposure to the underlying mortgages).
  - Each issuer must be approved by the CMHC in terms of their experience, management capability and infrastructure.
-