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Towards Pinstriped Unionism: Protecting Employee Entitlements Through Securitisation

Abstract
A series of well publicised corporate collapses has focused the minds of policy makers, business representatives, unionists and academics on the problem of how best to protect the entitlements owed to employees of a failed enterprise. The Federal Government has developed a two track policy – strengthening, on the one-hand, the insolvency provisions of the Corporations Law and, on the other, putting in place the 'Employee Entitlements Support Scheme' (EESS) to provide up-front payments to eligible workers. The EESS is fully funded by taxpayers at a three year cost of $135 million.

These policies are premised on the idea of market failure: some firms go bad, the State should step in. In an era where free-market ideology has been so deeply accepted, so that even the tea-lady day-trades, this seems a less than sanguine response. This paper attempts to posit an alternative, market-based solution where unions, government and the finance industry can all play a role. The aim is to develop a model for the securitisation of employee entitlements.

Keywords
employee entitlements, securitisation, insolvency, corporate law, Employee Entitlement Support Scheme

Cover Page Footnote
This is the first of two related pieces prepared under a Baker & McKenzie research fellowship. Whereas this paper is, in part, an analysis of the Employee Entitlement Support Scheme, the forthcoming article considers the new insolvency provisions in the Corporations Law. I would like to thank Baker & McKenzie for their generous support in financing these endeavours while also acknowledging the academic guidance of Professors John Farrar and Ross Buckley, both of Bond University, and Ben McLaughlin, partner in the Sydney office of Baker & McKenzie.

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ARTICLES

TOWARDS PINSTRIPED UNIONISM: PROTECTING EMPLOYEE ENTITLEMENTS THROUGH SECURITISATION*

by Christopher M Hughes+

Introduction

A series of well publicised corporate collapses has focused the minds of policy makers, business representatives, unionists and academics on the problem of how best to protect the entitlements owed to employees of a failed enterprise. The Federal Government has developed a two track policy – strengthening, on the one-hand, the insolvency provisions of the Corporations Law[1] and, on the other, putting in place the 'Employee Entitlements Support Scheme' (*EESS*)[2] to provide up-front payments to eligible workers. The *EESS* is fully funded by taxpayers at a three year cost of $135 million.[3]

These policies are premised on the idea of market failure: some firms go bad, the State should step in. In an era where free-market ideology has been so deeply accepted, so that even the tea-lady day-trades, this seems a less than sanguine response. This paper attempts to posit an alternative, market-based solution where unions, government and the finance industry can all play a role. The aim is to develop a model for the securitisation of employee entitlements.

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1 Carried into effect with the *Corporations Law Amendment (Employee Entitlements) Act* 2000 (Cth).

2 Commencing on January 1, 2000. Reith P, 'Federal Government Confirms Employee Entitlements Support Scheme and not Compulsory Insurance,' Media Release 64/00, April 27, 2000 (accessed at: http://www.dewrsb.gov.au/workplaceRelations/employeeEntitlements/default.asp).

3 Department of Employment, Workplace Relations and Small Business (DEWRSB) 'Practice Alert: Employee Entitlements Support Scheme,' in *Australian Insolvency Journal*, April/June 2000 at 42.

Produced by The Berkeley Electronic Press, 2000

Outline of the Problem

No one is quite sure of the annual figure of lost entitlements. The committee formed by the Government to do modelling on the *EESS* assumed a long-term trend of $110 million per annum, affecting 19,000 employees.[4] The ACTU has made an estimate of $140 million,[5] while a report prepared for the NSW Department of Industrial Relations has put the figure close to $180 million.[6] ASIC figures estimate that there were more than 7000 insolvencies last year.[7]

These numbers are significant. The problem has been with us for a long time. Public attention has been attracted only recently, however, in large part due to successful campaigning by union representatives. The celebrity of some of those on the employer side has also played a part. I will briefly discuss some high-profile collapses so that we have a more precise feel for the issues.

Previous bailouts

Cobar Mines

The first case to make the news was the January 1998 closure of the Cobar Mine in rural NSW. $10.8 million was owed to 250 employees of the company, a subsidiary of Ashanti.[8] Following union demands, the Australian Securities and Investments Commission (ASIC) launched an investigation into the collapse. At the heart of the inquiry was the withdrawal of a letter of financial support by the parent company, only days before the closure of the mine.[9] A rare settlement was reached where Ashanti agreed to contribute $6.5 million to settle its subsidiary's debts to the workforce.[10]

The Cobar miners were fortunate to be members of the well organised Construction, Forestry and Mining Employees Union (CFMEU), which

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4 Quoted in Reith P, 'Protection of Employee Entitlements on Employer Insolvency: Compulsory Insurance,' attachment to Media Release 64/00, April 27, 2000.

5 Quoted in Parliament of the Commonwealth of Australia, 'Corporations Law Amendment (Employee Entitlements) Bill 2000,' *Bills Digest*, No 125 1999/2000 (accessed at http://www.aph.gov.au/library/pubs/bd/1999-2000/2000 BD125.htm).

6 Ibid, citing The Benfield Greig Report.

7 Figure accessed from ASIC website, www.asic.gov.au.

8 Australian Securities and Investments Commission, 'Cobar Mines: ASIC Brokers $6.5M Settlement,' ASIC MR 98/375, published in *Australian Insolvency Journal*, Jan/Mar 1999 at 23.

9 Ibid.

10 Ibid.

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publicised the problem and succeeded in drawing a response from the government. Even though the full value of entitlements was not secured, recovering entitlements was on the public agenda. The sympathy aroused fed into the next, far more spectacular, insolvency; only on this occasion the parent entity was not quite so amenable.

Patrick Stevedores

In the late hours of April 7, 1998, 2000 waterside workers around the country were locked out of their workplaces. Their employers, members of the Patrick Stevedores group, had declared insolvency, terminated the workforce and appointed Administrators.[11] Whereas only seven months beforehand the employer companies 'were carrying on profitable businesses as stevedores and their assets exceeded their liabilities,'[12] they had suddenly entered a state of insolvency with a 'liability in respect of accrued leave entitlements and severance pay in the order of $125 million.'[13]

This change in fortune was not a symptom of industrial decline. It was the result of a covert, intra-group restructuring which saw the employer companies stripped of all assets other than non-exclusive labour supply contracts with the group operating company and loans to other group companies worth $14-$17 million.[14] When the parent operating company elected to terminate the labour supply agreements on April 7, a charge crystallised on employer company assets, including the outstanding intra group loans, rendering the employers hopelessly insolvent.

The government was prepared with a plan. On the day following the lock out, Minister Reith announced a $250 million stevedoring industry redundancy fund.[15] But this rapid intervention only served to further draw the government into the dispute. The workers were represented by one of the most militant trade unions in the country, the Maritime Union of Australia (MUA), and the union succeeded in portraying the whole affair as a union busting joint venture between the government and a shrewd employer.

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11 Kingsford Smith D, et al, 'Unveiling the Waterfront: corporate veil, directors' duties and voluntary administration,' (1998) 10 *BCLB* [172].

12 *Patrick Stevedores Operations (No 2) Pty Ltd v Maritime Union of Australia* [1998] HCA 30 (4 May 1998), per Gaudron J at para 88 (accessed at: http://www.austlii.edu.au/au/cases/cth/high_ct/1998/30.html).

13 Ibid.

14 Orr G, 'Conspiracy on the Waterfront,' (1998) 11 *AJLL* 159 at 160.

15 Ibid at 163.

The MUA's campaign succeeded both dockside and courtside. In a lateral move, the union engaged the services of a commercial silk[16] who successfully argued for an injunction to wind back the intra-group arrangements.[17] A conspiracy claim against the Minister, the Patrick group and its CEO, Chris Corrigan was dropped in the final settlement between the parties. Public pressure also led to a legislative response. Under the amended corporations law a director who attempts a similar restructuring, with the proven intent to deprive employees of their entitlements, will be guilty of a criminal offence.[18]

It is fair to say that the 'wharfies dispute' represented a milestone in the debate over workers and insolvency. Issues from quite separate areas of law and policy were raised simultaneously. Mr. Corrigan's manipulation of the corporate form involved a discussion on the merits and problems associated with limited liability for corporations.[19] Industrial Relations and welfare reform have been the sub-text to the Government's interventions. The MUA advanced their arguments, in part, within the discourse of corporate law. A cross-disciplinary policy was required.

Oakdale Collieries

The failure of the Oakdale mine in June 1999, again in regional NSW, meant that 125 workers lost their jobs. They were owed $6.3 million in long service leave and other entitlements.[20] The CFMEU, sensing growing public support and playing to the government's continuing sensitivity in the wake of the Patrick Stevedores affair, pursued a new claim to have the entitlements fully funded out of an existing industry long-service fund.[21] The union campaign included a one day national strike.[22]

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16 Julian Burnside QC

17 As confirmed by the High Court in *Patrick Stevedores Operations (No 2) Pty Ltd v Maritime Union of Australia* [1998] HCA 30 (4 May 1998) (accessed at: http://www.austlii.edu.au/au/cases/cth/high_ct/1998/30.html).

18 *Corporations Law* s596AB, inserted by the *Corporations Law Amendment (Employee Entitlements) Act* 2000.

19 As has been considered over the last two years by the Treasurer's Corporations and Securities Advisory Committee.

20 Norrington B and Grattan M, 'Bosses reject fund for sacked workers,' *The Sydney Morning Herald*, July 21, 1999 at 10. This sunset fund was unique to the coal industry and was financed through a small levy on producers.

21 Norrington B, 'Sacked miners win pay fight,' *The Sydney Morning Herald*, August 18, 1999 aat 7.

22 Ibid.

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In line with the views of employer groups,[23] Industrial Relations Minister Reith initially resisted the demands. As the campaign continued, and support for the government declined, the Prime Minister intervened and persuaded Cabinet to release the money. All entitlements were ultimately paid – the most favourable settlement to date. Government intervention was swift.

Prime Minister Howard was even nearer the centre of the next major insolvency, that of Australia's second major textile works. His brother was the Chairman.

National Textiles

$11 million was owed to 342 workers when National Textiles went into voluntary administration in January 2000. The Government again became rapidly involved, offering $7 million to the workers, conditional on creditors agreeing to the deed of arrangement proposed by the Administrator.[24] The money was sourced from another program within Department of Employment – the Regional Assistance Program.[25] The family relationship between National Textiles' Chairman and the Prime Minister ensured that the resolution was very much in the public eye. A template for consistent government intervention was nearly complete.

Development of the EESS

The search for a comprehensive scheme to deal with the issue intensified from the wharfies dispute onwards. Broadly, three mechanisms were discussed: national trust funds, a compulsory insurance scheme and a government funded safety net.

Trust Funds

The trust proposal was supported by some unions, including the Australian Manufacturing Workers Union.[26] It was a straightforward model requiring employers to make monthly contributions to cover the full cost of all accrued

23 The head of the Coal Association was publicly opposed to the move and the former CEO of the Business Council of Australia had previously recommended that the fund be abolished and the monies returned to producers – both cited in Norrington, ibid.

24 Wilkinson M and Verrender I, 'Ducking and Weaving,' *The Sydney Morning Herald*, February 19, 2000 at 42.

25 Reith P, 'Sydney Morning Herald is Wrong on National Textiles,' Media Release 91/00, June 21, 2000.

26 As reported in Norrington and Grattan, above n20.

entitlements. There would be industry-based trusts, administered nationally. Predictably, this suggestion was opposed by employer groups,[27] fearful of the impact on enterprise cash flows.[28] The government does not seem to have entertained the idea.

Compulsory Insurance

More support was registered for an insurance program. Indeed, the Labor party has placed a Bill before Parliament to enact such a scheme.[29] Its proposal is for superannuation funds to administer the service, funded by a 0.1% increase to the Superannuation Guarantee Levy. Levies are payable by the employer, except in the case of small employers, whose contributions are to be made by the Government.[30] Insurance policies would cover the full extent of a worker's entitlements. The Bill remains before the House but seems unlikely to win majority support.

The government also gave detailed consideration to an insurance option. A Committee was convened by Minister Reith to consider the proposal in some detail. Two scenarios were entertained – the first involving a flat premium charged to all employers, based on the number of workers. The second involved charging risk weighted premiums, calculated with reference to both industry and enterprise specific criteria.[31]

On either of these models, the government decided that benefits of compulsory insurance were outweighed by costs. Costs and difficulties in administration, the fear that insurers would not cover enterprises most at risk and the absence of a viable, international precedent were among the main reasons for rejecting the scheme.[32] The other stated drawback was the cost it would place on industry, discussed below. Ultimately, the government felt that it was better to institutionalise the welfare arrangements that had originated with the National Textiles collapse.

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27 The Australian Industry Group gave 'unequivocal advice' to its 11,500 member companies to reject the proposal, quoted in Norrington and Grattan, above n 20.

28 Under current arrangements, an employer merely makes a provision for entitlements on the company balance sheet. No money need be set aside.

29 *Employee Protection (Employee Entitlements Guarantee) Bill* 2000.

30 Bevis A, 'Labor's National Employee Entitlements Guarantee – a better way to protect employee entitlements,' Media Release, Jan 31, 2000.

31 Details of the Committee's findings and the government's response are summarised in Reith, above n 4.

32 Reith, above n 4.

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The Employee Entitlement Support Scheme

The *EESS* was formally selected as the preferred payment model in April 2000.[33] Insurance was rejected primarily because of the costs it would impose on business, especially on well-performing companies which already made adequate provisions for entitlements. The government did not want to make these firms subsidise poorly performing or unscrupulous employers.[34]

The scheme provides payments of up to $20,000 to eligible employees following the insolvency of their employer.[35] This amount is funded 50:50 by the Commonwealth and the relevant State Government, meaning that the maximum payout is $10,000 in the absence of a State contribution. The Government then stands in the employees' shoes to recover the money advanced upon the winding up of the company.

Twenty-nine weeks pay can be advanced under the *EESS*, covering outstanding entitlements of up to:

- 4 weeks unpaid/underpaid wages;
- 4 weeks annual leave (accrued in the preceding 12 months);
- 5 weeks pay in lieu of notice;
- 4 weeks redundancy pay (where entitled); and
- 12 weeks long service leave (where entitled).[36]

Outstanding superannuation contributions are not covered.[37]

Official commencement of the *EESS* was backdated to January 1, 2000 and it will be reviewed after three years. A budget allocation of $55 million was made for financial year 2000-2001 and $40 million will be provided in each of the next two fiscal years.[38]

The *EESS* has already been mobilised. In the National Textiles case, as mentioned, and more recently, 71 workers of Scone Fresh Meats received an

33 Reith, above n 2.
34 Reith, above n 4.
35 The mechanics of the scheme are quoted from the Department of Employment, Workplace Relations and Small Business, *Employee Entitlements Support Scheme Operational Arrangements*, April 2000 (accessed at: http://www.dewrsb.gov.au/workplaceRelations/employeeEntitlements/default.asp)
36 Ibid.
37 Although they can be recovered by a liquidator or employees under the new provisions in Part 5.8A of the *Corporations Law*.
38 DEWRSB, above n 3.

average of $2900[39] (or one-third of their outstanding entitlement) and 44 employees of Bedico Trading Pty Ltd (a Victorian dyeworks) were paid an average of $3460.[40] All monies were contributed by the Commonwealth.

Logic of the Policy

The Government sees the issue of funding unpaid entitlements very much in welfare terms - the scheme acts as a kind of cushion against the (seemingly) inevitable impact of economic change. Minister Reith's announcement of the *EESS* stated:

> [w]hile there can be no doubt about the Federal Government's commitment to labour market reform, the Government is just as committed to helping people who are hurt through no fault of their own as a result of economic reform and the modernisation of the Australian economy.[41]

Government policy is being prompted by a 'market failure' ideology. According to this, the State plays a residual role, intervening when market outcomes adversely affect certain participants. Further, minimal state intervention operates as an alternative to making structural changes to the market framework and institutions.

As a demonstration of this, consider the fate of Opposition attempts in the senate to amend the *Corporations Law Amendment (Employee Entitlements) Act* 2000, so that contribution and pooling orders could more readily have been made against related entities in favour of creditors of an insolvent company.[42] It is an understatement to call the Government's rejection of the amendment in the House of Representatives 'vehement.' The Minister for Financial Services and Regulation styled the amendment as 'the most disgusting piece of legislative change that I have seen while I have been in this parliament.'[43] Hyperbole aside, in this and other recent reforms to the Corporations Law,[44] the

39 Reith P, 'Reith Delivers on Employee Entitlements,' Media Release 78/00, May 31, 2000.

40 Reith P, 'Commonwealth Pays its Share of Employee Entitlements for Victorian Workers,' Media Release 111/00, July 12, 2000.

41 Reith, above n 4.

42 Passed by the Senate as Item 4A of Schedule 1 to the *Corporations Law Amendment (Employee Entitlements) Bill* 2000.

43 Hockey J, speech to Parliament in Consideration of Senate Message on the Corporations Law Amendment (Employee Entitlement) Bill, *House of Representatives Hansard*, June 7, 2000 at 17247.

44 *Corporate Law Economic Reform Program Act* 1999.

Government has pursued a clear policy of allowing markets to operate freely, subject only to limited intervention in favour of particular groups.[45]

The fundamental criticism of this policy framework is that, ultimately, taxpayers and workers indemnify the controllers of failed enterprise in meeting the obligations which they voluntarily entered into. Such a situation seems even harsher when the corporate form is manipulated, as in the case of Patricks', or when 'phoenix' companies spring up to enjoy the opportunities left by a failed entity. Taxpayers may legitimately wonder why they are being asked to meet the obligations of sharp or incompetent operators.

The remainder of this paper is a modest response to the impasse. My thesis is that the policy options as to who should meet the expenses of corporate failure are not confined to the present three-way choice – workers, employers or taxpayers. More creative responses can be fashioned from among the existing resources in our economic environment. The Government itself has recognised,

> liberalisation of world capital markets in combination with technological developments in information and telecommunication industries have fundamentally altered the way business operates.[46]

Such a recognition does not sit comfortably with the fairly unrefined 'market failure' theme behind the *EESS*. Why not see if some of these sophisticated market practices can be adapted to the problem? I believe that the common financing technique of securitisation can be drafted for this purpose.

What is Securitisation?

Overview

Securitisation has been snappily described as 'a process whereby assets with an income stream are pooled and converted into securities for trading in the capital market.'[47] It is a widely employed corporate financing technique.

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45 Such as 'small investors' in the case of the share acquisition and fundraising reforms. For a short summary of these see McLaughlin B and Hughes C, 'Amendments to the fundraising provisions of the Australian Corporations Law,' *Baker & McKenzie Corporate Law Update*, April 2000.

46 Parliament of the Commonwealth of Australia, *Corporate Law Economic Reform Program Bill 1998: Explanatory Memorandum*, para 2.4.

47 Ramsay I, 'Financial Innovation and Regulation: The Case of Securitisation,' (1993) 4 JBFLP 170.

It begins with the owner of a pool of assets selling them into a specially formed entity (special purpose vehicle (SPV) in the parlance), often established as a trust. The SPV is commonly established by the vendor, although its separate personality is a vital element in a successful deal. The SPV pays the vendor (or 'originator') for the assets in full. The consideration for the sale is generated by the SPV issuing securities, often in the form of fixed rate bonds. The bonds are secured against the assets and the coupon payments and principal repayments are met by the SPV 'paying through' to bond holders the cash flow generated by the underlying assets. Often the originator has a continuing role in servicing the bonds. Depending on the legal structure of the issue, these bonds may be listed on a secondary market.

The art of securitisation lies in structuring the transaction to minimise the difference between the discounted value for the future assets paid to the originator and the interest which must be paid to the bond holders, coupled with the cost of administering the scheme. The lower the spread, the more likely that a portion of the cash flow can be retained by the SPV and returned to the controller/beneficiary as a dividend or distribution. Professional securitisers live on this margin.[48]

If executed successfully, securitisation is a means for an originator to raise funds more cheaply than they could by borrowing on their own name. This is because the SPV does the fundraising and the structure of the deal ensures that it has a better credit rating than the originating entity. The SPV is a completely separate, 'bankruptcy remote' entity whose value is determined by the sole asset that it purchases from the originator. The only real risk is that the asset value will not support the obligations owed to security holders. Lessening this risk is achieved through a number of methods, including:

- over-collateralising the asset pool (the SPV holds assets with a greater value than the amount of bonds issued);
- the use of credit enhancement techniques, such as a standby letter of credit, to cover a certain percentage of defaults in the payment of receipts;
- insuring against the risk of a default;
- soliciting third party guarantees from well rated entities; or
- issuing senior and subordinate bonds.

Clearly, a range of parties need to be involved in a securitisation. Originators, issuers, legal and financial advisers, ratings agencies, third party credit

48 As noted by home mortgage securitiser RAMS in their submission to the Financial System Inquiry, 1996 (discussed below).

enhancers, servicers and an investor trustee together support each transaction.[49] From the originator's and issuer's point of view, the analysis of a credit rating agency will be of paramount importance. This is because the securities must fit a particular profile to attract sufficient investor support. Scott and Wellons[50] suggest that ratings agencies and investors look particularly for the following features:

- a large asset pool[51] (which reduces the proportional expenses of structuring and issuing the deal);
- a low default rate from the obligors who provide the underlying cash flow;
- insensitivity to interest rate changes;
- adequate collateral/credit enhancement;
- limited prepayment risk;
- short maturities; and
- homogenous asset pools – 'similar credit quality, maturity and interest rate profile' of assets in the asset pool aid with credit ratings.[52]

To this last factor could be added the requirement that the asset pool be adequately diversified in terms of geographic and other social factors.[53]

Securities seem to be marketed mainly to institutional investors. There are several reasons for this, most related to reducing the transaction costs of the borrower. For example, under Australian law, an offer of securities does not need to be made under a prospectus where the subscription price is over $500,000 or if the purchaser is a certified 'sophisticated investor.'[54] Another reason could be the relative inaccessibility of the bond market to retail investors.

Securitisation is popular. The United States has the most developed market and in 1997 transactions worth more than $US700 billion were undertaken in that

49 Finch A, 'Securitisation,' (1995) 6 *JBFLP* 247 at 253.
50 Scott H and Wellons P, *International Finance: Transactions, Policy and Regulation* (2nd ed), The Foundation Press, Westbury, NY (1995).
51 Standard & Poor's director of Australian securitisation has been quoted as saying that $50 million would be the minimum deal size, in Van Leeuwen H, 'Creative…but is it safe for locals?' *The Australian Financial Review*, Securitisation Special Report, April 27, 1999 at 5.
52 Scott and Wellons, above n 50 at 707.
53 As noted by Finch, above n 49 at 249.
54 *Corporations Law* s708(8)(a)-(c), as discussed in McLaughlin and Hughes, above n 45.

market alone.[55] While issuance outside the USA is not as large, it is growing as originators and investors become more familiar with the concept. With increased popularity has come innovation. As one practitioner observed, 'there seems no limit to the ability of the markets to adapt the basic principles of securitisation deals to allow for the peculiar legal and economic characteristics of new asset classes.'[56]

The best way of understanding the technique is through observing its practical operation. In the next section I briefly survey the development of securitisation in its original market, the USA, before considering some recent innovations. The section concludes with a discussion of the practice of securitisation in Australia.

Development and Application of Securitisation in the USA

Government agencies made a decisive contribution to the rise of mortgage backed securitisation programs in the United States. By 1994 more than US$1 trillion worth of these securities were outstanding.[57] They were the second largest category of bonds issued in that market, after Treasury bonds.[58]

Growth followed the institutionalisation of a secondary mortgage debt market. In the 1930's depression the US Federal Government established the Federal Housing Administration (FHA) to insure mortgage loans made to low income earners.[59] This successful program was repeated after the second world war by the Veterans Association.[60] To provide liquidity in the lending market, the Federal National Mortgage Association (known as 'Fannie Mae') began in 1938 to purchase FHA loans from originators, funded by issuing commercial paper, thus boosting the ability of mortgage lenders to originate more loans.[61]

In 1968 the Government National Mortgage Association (known as 'Ginnie Mae') took the next logical step, issuing the first ever FHA/VA insured mortgage backed securities in 1970.[62] The Federal Home Loan Mortgage Corporation (known as 'Freddie Mac') followed up in 1971 with an issue backed by non-Government assisted mortgages.[63]

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55 Humphreys P, 'United States,' *IFLR Special Supplement – Securitization*, June, 1998 at 72.
56 Ibid at 73.
57 Scott and Wellons, above n 50 at 705.
58 OECD/Thompson J, *Securitization: An International Perspective*, Paris (1995) 119.
59 Scott and Wellons, above n 50 at 717.
60 Ibid.
61 Ibid at 718.
62 Ibid.
63 Ibid.

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The next stage of development was the securitisation of 'collateralised mortgage obligations' – CMOs. These were conceived by the private investment community in the early 1980's and are really a further securitisation (or 'repackaging') of the bonds sold by the Fannie Mae and kindred issuers.[64] They are a complicated device, reallocating some of the prepayment and other risks inherent in the original bonds through issuing several tranches of new bonds with different priorities and an appeal to different sets of investors.[65] Some CMO issues had upwards of 100 tranches.[66]

The complexity of these new structures challenged existing Government revenue and accounting policies. In keeping with its initial support for a secondary mortgage backed market, tax concessions were made in 1986.[67] A transaction structure which provided investors with a favourable tax position while also allowing issuers to move the assets off balance sheet was mandated. The new investment forms were named Real Estate Mortgage Investment Conduits, or REMICs.[68]

With the direct or implied involvement of the US Government in these securitisation programs there was no early drive to design new credit enhancement techniques. These have developed alongside the market for non-agency supported 'private label' CMOs and with the application of securitisation to non-mortgage assets.[69] The importance of ratings agencies has also increased.[70]

Although the same ratings can be achieved, these securities do not enjoy the same support in the market place. In the mid-1990's, only 14% of securitised mortgages were 'private label.'[71] Contrast this figure with the share of all mortgages that are securitised – approximately two-thirds[72] - and the dominant share of mortgage backed securities in the total of securitised debt – around 85% in 1993.[73] It seems that even in this the most advanced market, financial

64 Ibid.
65 OECD/Thompson J, above n 58 at 121.
66 Ibid at 122.
67 Ibid at 121.
68 Ibid.
69 Ibid at 122.
70 Ibid.
71 Reserve Bank of Australia, *Submission to the Financial System Inquiry*, 1996 at 5 (accessed at: http://www.treasury.gov.au/default.asp?main=/publications/financialsysteminquiry(wallisreport)/pubsubs/000111a.doc).
72 Ibid.
73 Scott and Wellons, above n 50 at 715.

innovation occurred only on the coat-tails of state intervention, and pure private transactions run a poor second to those benefiting from the Government's stewardship.

Some innovation has occurred in the private sector, however, and the variety of assets securitised shows plainly how flexible the technique can be.

Innovative Securitisations

Credit card and car loan receivables were behind 66% of non-mortgage securitisations in the USA in 1994.[74] Car loans are readily adaptable to the traditional mortgage backed model, which probably explains their popularity with issuers, while the interest in securitising credit card receipts probably lies in the spread between what investors are paid and what obligors are charged.[75]

Securitisation need not be confined to these 'easy' asset classes however. It has been used widely and effectively in moving inherently risky or problematic assets, such as emerging market debt,[76] assets of companies in bankruptcy proceedings,[77] and student loans.[78]

Australia's BHP, thinking laterally, engineered a novel international asset backed issue in 1993.[79] The company securitised $500 million in non-interest employee share and option plan (ESOP) loans. The total of these loans represented approximately 3% of the company's assets. The share plan had other benefits to BHP – it was conceived, in part, as a takeover defence in the mid-1980's – but contributed to the company's high overall indebtedness. Moving the unperforming loans off-balance sheet was a creative tool in its debt reduction strategy. The company and its employees also retained the benefit of the ESOP.

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74 Ibid at 716, citing the Asset Sales Report of January 16, 1995.

75 These twin factors are suggested as general indicia for selecting suitable assets to securitise, OECD/Thompson J, above n 58 at 122.

76 Done via a Collateralised Bond Offering (twin CMO) where high-yield assets can be purchased at a discount in the secondary market and their risk profile repackaged for easy digestion by domestic investors. Discussed in OECD/Thompson J, above n 58 and Humphreys, above n 55.

77 As in the Allied Stores Corporation workout, described in detail in Glover S, 'Structured Finance Goes Chapter 11: Asset Securitization by Reorganising Companies,' (1992) 47 *The Business Lawyer* 611.

78 Finch, above n 49 at 254.

79 Written up in Scott and Wellons, above n 50 at 725 and following. My discussion of the transaction is wholly derived from their material.

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Securitisation has also been embraced by non-corporate entities. Performer David Bowie has led the way with a successful securitisation of royalty receipts from his recording catalogue.[80] The US$55 million dollar issue of 'Bowie bonds'[81] showed that American wholesale investors could see value in the spiders from mars. The benefit to Bowie was the forward payment of his receipts, for a relatively low price, given that the issue was credit enhanced by his label EMI.[82]

Such innovations demonstrate that securitisation can be applied in both unorthodox and socially beneficial ways. Investor familiarity with the concept and supportive regulations seem to be pre-conditions for novel issues. With this in mind, I now turn to an assessment of the Australian market.

Securitisation in Australia

Outline

Reserve Bank of Australia figures show that $60.3 billion of Australian securitised debt was outstanding at the end of the March quarter 2000. $39.2 billion of this was backed by residential mortgages.[83] More than half ($34.7 billion) of the total was issued in the domestic market.[84]

The value and volume of issues has increased dramatically. In March 1990 the Reserve Bank reported only $4.1 billion of outstanding mortgage backed securities, which was also the only form of securitised debt reported in the domestic market.[85] Whilst a fifteen fold growth rate over a decade is impressive, there remains scope for further rises. In the United States more than 50% of home loans are routinely securitised; the Australian figure is nearer to 10%.[86]

Numbers are moving favourably on the demand side. As mentioned, the majority of purchasers are 'institutional' or wholesale investors and the amount of funds managed by these entities has shown marked growth as deregulation and other government policies[87] take effect. For example, assets of

80 Bloomberg, 'Pavarotti hits discordant note with bonds,' *The Australian*, Dec 3, 1997.
81 The name given to the securities by Clark K, 'On the frontier of creative finance: how Wall Street can securitize anything,' *Fortune*, April 28, 1997.
82 Clark, *ibid* and Humphreys, above n 55 at 76.
83 Reserve Bank of Australia, 'Securitisation Vehicles,' B1600HIST.XLS (spreadsheet), July 2000 (accessed at: http://www.rba.gov.au/bulletin/ b_tables.html).
84 Ibid.
85 Ibid.
86 'Australian Financial Markets: Looking Back and Looking Ahead,' speech by Assistant Governor (Financial Markets) R Battelino, *RBA Bulletin*, March 2000 at 19.
87 Such as the expansion of compulsory superannuation schemes.

superannuation funds increased 350% to $260 billion in the decade to March 2000.[88] Cash management trusts, a favoured audience for short term issuers, achieved a six-fold increase to $23 billion over the same period.[89]

The BHP deal notwithstanding, securitisation in Australia is dominated by home-mortgage backed issues. Developments in this market are described below.

Mortgage Backed Securitisation

Consistent with the experience in the USA, the first mortgage backed securitisations relied on substantial government involvement. Several States sponsored programs in the mid-1980s, often with the policy goal of assisting low-middle income families to own their own homes. The New South Wales government also followed the US example in labelling its 25% owned mortgage conduit with a memorable acronym – FANMAC Ltd, incorporated in 1985.[90] At its highest, FANMAC had $4.6 billion of securities on issue, but this declined to around $500 million by the mid-1990's.[91] There was a concomitant 'withering' of new issues.[92]

FANMAC seems to be regarded as a valuable lesson for the mortgage finance sector in what not to do. The quality of the underlying assets were too poor and the terms of the mortgages also increased the risk of default – the repayment obligations increased precisely at the time of the early 1990's recession, with its associated high unemployment.[93] The pass-through structure of the issue transferred some of these losses to investors.[94]

Early failure has not diminished interest in securitisation as a mortgage financing tool, as the figures quoted earlier demonstrate. It has perhaps skewed the market, however, in that private issuers dominate.

Several specialist mortgage origination and securitisation firms entered the market in the 1990's and they have done well in capturing business from the

88 Reserve Bank of Australia, 'Total Assets of Financial Institutions,' B01HIST.XLS (spreadsheet), July 2000.
89 Ibid.
90 Finch, above n 49 at 259.
91 Ibid.
92 RAMS Home Loans, *A Submission to the Financial System Inquiry*, Sydney, Sept 9, 1996 (accessed at: http://www.treasury.gov.au/default.asp?main=/publications/financialsysteminquiry(wallisreport)/pubsubs/000128.doc).
93 Finch, above n 49 at 259.
94 Ibid.

banks in the home mortgage sector. One such company, RAMS, estimated that by 1996 17% of new mortgage finance commitments were sourced from non-bank originators.[95] The banks have responded by embracing securitisation to take their own mortgage portfolios off-balance sheet. Westpac sold $2billion dollars worth of securities in a single global offering in 1998, at the time the biggest debt issue by an Australian entity.[96]

Mortgage backed securities are carefully structured to achieve the highest credit ratings. RAMS, for example, uses a senior/subordinate pass through structure to provide credit enhancement and liquidity.[97] Third party support is present in the form of a 100% principal and interest repayment insurance policy on each mortgage, provided from highly rated specialist lenders' mortgage insurers.[98]

On the other side of the transaction, RAMS controls all aspects of the lending process to home buyers. With the criteria of the ratings' agencies in mind, cautious lending practices are adopted.[99] In addition, a *de facto* 'continuous disclosure' program operates between the originator and the ratings agency so that the rating is maintained throughout the life of the bond.[100]

Putting together each deal is 'an extremely legalistic, document-oriented exercise.'[101] Complexity means that the market is dominated by a handful of issuers, although new firms are emerging. Five of the six off-shore issuers of mortgage backed bonds in the first half of 2000 were first time securitisers.[102]

The growing expertise and obvious successes in mortgage securitisation is leading to increased securitisation of other asset types. Some innovative examples are discussed below.

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95 Above n 92 at 28, basing their calculation on ABS figures.

96 Hogan R, 'Forging Ahead,' *The Australian Financial Review*, Securitisation Special Report, April 27, 1999 at 7.

97 Above n 92 at 17.

98 Such as the Commonwealth owned, AAA rated, Housing Loan Insurance Company. RAMS, above n 92 at 20.

99 Ibid. RAMS states that the usual criteria for assessing the mortgage pool are the 'size, volume, type, uses, amortisation and maturity, geographic spread and loan to value gearing. In addition each mortgage is assessed for loan to valuation, income sufficiency, loan documentation and general insurance' at 17-18.

100 Ibid at 23.

101 Ibid at 18.

102 Hogan R, 'Half's record run shows a shift overseas,' *The Australian Financial Review*, July 3, 2000, MW 9.

Innovation

We have already seen how BHP adopted securitisation as a novel means to move an unperforming asset off-balance sheet. Demand for non-mortgage securities has also grown as fixed-interest investors have sought to diversify.[103]

Innovation, although recent, has come in a flurry – 'in 1998 investors bought paper for the first time in securitisations such as aircraft leases, equipment and car leases, hire purchase and credit card receivables.'[104]

The newness of the market and, in some cases, the absence of historical data on the asset pool has increased costs – both in credit enhancement and coupon payments.[105] With the hire-purchase receivable transaction, average losses were multiplied by five and the credit protection was aimed slightly beyond this.[106]

On the positive side, the asset backed deals have been smaller, which has assisted with their sale. Practitioner Simon Robinson has observed 'you don't have to convince the whole market when you've only got small deals like the auto deal – you only have to convince three or four investors.'[107] Financial deregulation combined with technological development also makes it easier to find investors offshore – just as BHP did with their ESOP receivables.[108]

That the domestic market for securitised offerings has matured to its current state is impressive, given the absence of overt and sustained government intervention. While positive changes have occurred in our securities laws, for example by making electronic offerings more simple and by having simplified procedures for wholesale issues,[109] more official support would be welcome. Visible government support is a definite pre-requisite to the innovation that I am proposing in the employee entitlements field.

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103 Hogan, above n 96 at 7.
104 Van Leeuwen, above n 51 at 5.
105 Ibid.
106 Van Leeuwen H, 'Bankers Trust securing the future,' *The Australian Financial* Securitisation Special Report, April 27, 1999, referring to the Sanwa Finance $150 million deal at 6.
107 Van Leeuwen, above n 51 at 5.
108 Discussed below and fully described in Scott and Wellons, above n 50 at 725 and following.
109 McLaughlin and Hughes, above n 45.

Securitising Employee Entitlements: A Model

In this section I hope to synthesise what has been presented above into a working model for the securitisation of employee entitlements. In such a transaction, workers, via their union body, take the role of originators and the government plays a part as a third party credit enhancer. Unions could provide continuing support as a servicer or that role could be played by a professional institution, such as an existing 'affinity lender' as in the example of the ACTU – National Mutual Home Loans Scheme.[110] Domestic institutional investors, particularly industry superannuation funds, would be the likely purchasers of the securities. Consider the investment as the future of the super.[111]

To simplify matters, I will confine the entitlements backing the issue to annual leave and match the maturities – ie, assume that 4 weeks leave is taken in one block and the securities are fully redeemed after twelve months. There is no reason in principle, however, why the full range of entitlements could not be securitised.

In an insolvency, unpaid entitlements are a debt by the employer which must be proved by workers, who rank as priority unsecured creditors.[112] Casting the relationship in this way assists us to envisage the transaction. In economic terms, workers are merely continuing creditors. Their wages and entitlements are like other trade receivables. Similarly with other asset backed securitisations, we need to combine these receivables into an asset pool.

Under most awards, permanent employees are eligible for four weeks paid annual leave with a 17.5% loading. For my purposes, we could consider this loading as interest – it could be the cash flow to provide the necessary coupon payment. An annual income of $40,000 stands behind the *EESS* calculations and I will adopt that here. In rounded terms, this equates to $760 per week. Four weeks leave would be valued at $3570 in total - $3040 in ordinary time earnings (principal) and $530 in loading (interest). To generate an asset pool of $50 million,[113] we therefore need to combine the annual leave of 16, 450 workers.

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110 Discussed in WESTPAC, *Submission to the Financial System Inquiry*, 1996 at 67 (accessed at: http://www.treasury.gov.au/default.asp?main=/publications/financialsysteminquiry(wallisreport)/finalreport/chapt04.doc).

111 Apologies to Bernie Fraser.

112 *Corporations Law*, s556(1).

113 Which has been suggested as the minimum pool size: Van Leewun, above n 51 at 5.

In planning the deal, we must consider the costs of servicing and issue costs. Most importantly, we need to calculate the cost of credit enhancing the pool so as to achieve the AAA rating.

An asset pool made up of annual leave receivables meets several of the criteria usually considered essential by investors and ratings agencies.[114] It is a homogenous pool, in the sense that it is comprised of receivables of the same kind; it is insensitive to interest rate changes – loading is enshrined in the relevant Award; there is no pre-payment risk and the maturity is short. We could diversify the pool by ensuring that cash flows were sourced from different regions and from different industries.

Default risk stands as the major concern – indeed, the existence of that risk is motivating the whole transaction. It must be managed.

There were approximately 9 million people employed in Australia in June 2000.[115] In doing the modelling for a compulsory insurance scheme, the Government's committee assumed that up to 19,000 employees per year lost their entitlements.[116] This is a default rate of 0.2%. Following the practice with the first hire-purchase receivable securitisation, discussed above, we should multiply this default rate by 5 to achieve a ratings figure of 1%.[117] Therefore, we need either insurance cover, a stand-by letter of credit or some other enhancement to the value of $500,000.

Credit enhancement would be the obvious role for government. Under the *EESS* it has agreed to pay out up to $10,000 to each eligible employee.[118] Guaranteeing all principal and interest repayments in my entitlements pools would cost significantly less than this. Alternatively, it could allow its lenders' mortgage agency to insure the pool, again at a significant discount to what it has set aside under the *EESS*.

Whether the pool is privately covered or enjoys some form of sovereign backing, the maximum additional expense should be $500,000. With this support and a sound asset pool, our SPV should achieve the highest rating. Now we must price and execute the issue.

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114 Refer to the list suggested by Scott and Wellons, above n 52, discussed below.

115 Australian Bureau of Statistics, 'Labour Force Australia, '*ABS Catalogue No 6203.0*, June 2000 (accessed at: http://www.abs.gov.au/).

116 Reith, above n 4.

117 Above n 106.

118 Above n 2.

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If we assume that twelve month AAA rated domestic notes trade at 23 basis points over the 30-day bank bill swap rate,[119] which was quoted on August 3, 2000 at 6.32%,[120] this would require a principal and coupon repayment of $53,275,000. If we add our service, transaction and credit enhancement costs, the complete obligation will be in the order of $55,000,000.

How can the originator/issuer meet the $5,000,000 shortfall? One option would be to fully fund it from out of the leave loading payments. This would cost each worker/originator $304, which equates to 57% of their loading. For corporate originators, this cost would be acceptable. But here we are not applying securitisation in the usual way. The cost would be unattractive to most employees, yet some may elect to forego some of their loading as a trade-off to receiving their annual payment at the start of the year, rather than the end.

A second option would be for the servicer to hold the money on trust until the leave is actually taken at the end of the twelve month period. The only shortfall would thus be the difference between the $5,000,000 shortfall and the return on investment. If the $50,000,000 were invested on August 3 at the 12 month Fixed Bank Bill Lending Indicator Rate of 6.58%, the shortfall would be $1.7 million, or $105 per worker.

The challenge is, of course, to get this figure as close to zero as possible. Decreasing transaction costs by increasing the size of the asset pool or lessening the credit enhancement requirements would be one area to address. Another tactic would be to reduce, or even invert, the spread between receipts and payments through a combination of more successful investing or lowering the coupon payments. Sovereign backing of the asset pool would be of immense assistance in the latter challenge. In any event, on my conservative calculations, protecting the holiday pay of each Australian worker has been reduced to a $100 problem.

The final task is to give the securities a marketable name. The only acronym that springs to mind containing the two 'E's' of employee entitlements is the unattractive sounding *EEL*. I have instead chosen a more distinguished sounding and historically meaningful title: *Corrigan Bonds*.

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119 In October 1999 Bankers' Trust securitised $200 million in motor vehicle hire purchase receivables for Orix Australia where the 12 month AAA rates were priced at this margin: Van Leeuwen, above n106.

120 Based on Bloomberg figures quoted in 'Market Wrap,' *The Australian Financial Review*, August 4, 2000, MW 22.

With their track record of support for securitised offerings, I have no doubt that Australian fund managers will not hesitate in diversifying their fixed interest portfolios with a subscription for government-sponsored *Corrigans*.

Conclusion

This paper is a practical contribution to the emergent cross-disciplinary debate on protecting the positions of workers when insolvency strikes. I have tried to go beyond the usual responses of welfare intervention or the alternative of letting the loss lie where it falls.

The interaction between corporate and employment law theory and practice is an exciting development. Perhaps surprisingly, it is the unions who have led the way in applying corporate law ideas to their workplace problems. The MUA successfully resisted the Patrick's attacks partly via arguments founded on *Corporations Law* provisions. Their use of a commerical law barrister was innovative.

In more recent developments, union leaders have responded to the idea of using the influence that they have as superannuation trustees to pressure companies to behave in socially responsible ways. Doug Cameron, the leader of the AMWU, recently said in a televised interview:

> [l]ook, I'm on the board of the Superannuation Trust of Australia, a very successful fund with both employer and union representatives. There is a debate about corporate governance going on, about how, you know, big business simply ravages companies and simply ravages economies and the environment. We want to have an influence on that, and it's a legitimate position for workers and their representatives to be concerned about exploitation and the destruction of the environment and child labour. These are issues of some social conscience.[121]

The head of the American Federation of Labor (ACTU equivalent) recently advanced similar ideas at the ACTU conference.[122] In fact, the campaign has already begun as unions, via their superannuation fund holdings, succeeded for the first time in moving a global shareholder resolution at meetings of members of the Rio Tinto mining group.[123] One resolution, calling for the company to

121 Australian Broadcasting Corporation, 'Workers Inc,' *Lateline* (transcript of broadcast), June 28, 2000 (accessed at: http://www.abc.net.au/lateline/s146236.htm).

122 Ibid.

123 Long S, 'Unions give themselves the high-fives,' *The Australian Financial Review*, May 25, 2000 at 57.

adhere to International Labour Organisation standards, received nearly 20% support from voters – or, in numerical terms, 95,413,653 votes.[124]

So we are moving towards pinstriped unionism. I see the development of *Corrigan Bonds* as a practical adjunct to this process.

124 Ibid.