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Dear Neil

Discussion Paper – Simplifying the prudential approach to securitisation

The Australian Securitisation Forum (ASF) thanks the Australian Prudential Regulation Authority (APRA) for the opportunity to provide comment on the Discussion Paper dated 29 April 2014 and titled "Simplifying the prudential approach to securitisation" (the Discussion Paper).

The ASF represents participants in the Australian securitisation market. The ASF's members comprise ADIs and non-ADIs that use securitisation for funding and regulatory capital management purposes. Membership also includes underwriters, investors, servicers and professional advisors working on securitisation transactions issued in both the Australian domestic market and global markets.

The ASF supports APRA's goal of simplifying and clarifying the prudential approach to securitisation. This submission is structured to address the major points in the Discussion Paper we believe will be instrumental in shaping the future of the Australian securitisation market. It is our hope that the outcome of the review of APS 120 will be to create a prudential framework that underpins a large and structurally simple securitisation market that ADIs mainly use for funding-only transactions but provides the option for regulatory capital relief to be achieved. The ASF believes the new APS 120 should provide a framework in which both large and small ADIs as well as non-ADIs can use securitisation to access term funding markets and broaden their domestic and global investor bases.

Our submission is structured to provide comment on the following topics:

- Executive Summary
- Section 1 – Date Based calls and Master Trust Securitisation Structures
- Section 2 – Securitisation Warehouse Arrangements
- Section 3 – Determination of Capital Relief and Risk Retention
- Section 4 - Other Technical Issues
- Section 5 - Cost-Benefit Analysis Information

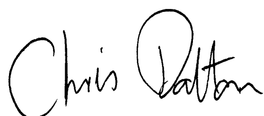
The ASF considers the review by APRA of its prudential approach to securitisation as being vitally important to the future of what has been a successful Australian securitisation market. We look forward to meeting with you to discuss this submission and provide further market information prior to the release of the second consultation package and draft prudential standard that you have indicated will be released in the first half of 2015.

The ASF notes that a number of domestic and international efforts may influence APRA's next consultation package. These include:

- the final report of the Financial System Inquiry
- finalisation by the Basel Committee on Banking Supervision's of its Securitisation Framework
- response by the Bank of England and European Central Bank to submissions received to the joint Discussion Paper titled "The case for a better functioning securitisation market in the European Union" and dated May 2014
- rules applicable to securitisations to be implemented by U.S. regulators under the Dodd Frank Act

Please let me know if you have any immediate questions on our submission, otherwise I will be in contact in the coming months to request an opportunity to meet and discuss our submission in greater detail.

Yours sincerely



Chris Dalton

Executive Summary

General Comments

1. The ASF welcomes the initiative that APRA has taken to review the securitisation standard (APS 120). In addition to fostering further sustainable growth of the securitisation market, this initiative will assist in simplifying the regulatory requirement, particularly for funding only securitisation transactions, and provide for a framework that meets the current market environment, which should serve the financial system well for the next decade.

2. We suggest the measure of success of an updated securitisation standard should be:

   - a substantial increase in the amount of domestic and offshore securitisation transactions issued by ADIs which will diversify their funding sources and lengthen the tenor of their funding;
   - increased participation from real money investors in A$ RMBS transactions;
   - increased participation from offshore investors in non-AUD RMBS tranches;
   - securitisation of other asset classes by ADIs, such as SME loans and credit cards;
   - the ability of ADIs to use securitisation as an alternative method of funding non-ADIs; and
   - a resilient and sustainable financial system.

Funding-only and Revolving and Master Trust Structures

3. The ASF welcomes APRA's proposal to allow date-based calls for funding only securitisations. However, the proviso in the Discussion Paper that a date-based call can be set no earlier than the projected 10% clean-up point eliminates much of the potential value that date-based calls would provide. The ASF submits that the proviso should be removed.

4. The ASF submits that the proposal for the master trusts outlined in the Discussion Paper should be reconsidered to reflect an Australian master trust framework that would:

   - allow funding-only revolving structures where ADIs hold full capital against the assets being securitised to enable issuance of soft bullet securities while limiting the over encumbrance of assets;
   - comprise simple A class/B class structure which satisfies any skin in the game requirements;
   - not subordinate an ADI's interest in A class notes to the interest of the investors and ensures any losses get allocated pro-rata and pari-passu at all times;
   - include date based calls, which will be captured in the ADI's liquidity management strategy and regulated according to prudential standard APS210; and
   - include early amortisation triggers that are not fundamentally different from currently included in typical Australian securitisations such as an insolvency of the ADI, Class A charge-off and servicer termination event. These triggers would lead to extension risk of the notes being shared with external investors and the structure moves from a revolving to a pass-through structure.

Warehouse Arrangements

5. Warehouse arrangements are vital to competition and provide efficient access to funding for both ADIs and non-ADIs. Assets are accumulated in warehouses which may later be refinanced via term securitisations. Typically the warehouse arrangements will remain on foot and form part of ADI and non-ADI's funding plans. They are, however, ultimately just another funding structure for lenders that should not be thought of being significantly different from secured loans or outright receivable purchases.

6. The ASF questions if specific warehouse rules are required at all in the new APS 120 as many warehouse arrangements are currently structured so the term of the funding matches the term of the underlying assets. If they are needed, such rules should be confined to arrangements that involve an asset and liability mismatch only.

7. The ASF believes that regulatory capital relief for warehouse arrangements should only be permitted if certain conditions are satisfied.

8. Industry supports the proposal for warehouse facilities to have at least two tranches

9. Where the warehouse arrangement is a funding only transaction or if the substance of the arrangement mirrors that of a closed pool match funded arrangement, there is no need for the proposed 12 month limit to residential mortgages remaining in a warehouse.

10. Clean up calls should be permitted in warehouse arrangements to allow the termination of a warehouse arrangement.

Capital Relief and Risk Retention

11. The ASF does not support the proposal as outlined in the Discussion Paper relating to credit risk retention. A primary concern with the proposal set out in the Discussion Paper is the manner in the proposed credit risk retention rules have been explicitly tied to the rules regarding capital relief. We believe capital relief and risk retention are separate issues and need to be addressed independently of each other.

12. We submit that the consideration of any minimum credit risk retention for Australia should be deferred until the next phase of the APS 120 consultation process. We note that global reviews such as the IOSCO-BCBS joint working group are re-evaluating the impact of regulations introduced since the financial crisis on global securitisation markets. We note U.S. is also yet to settle on and implement any risk retention requirement for securitisations.

13. The ASF has supported a risk-sensitive approach to capital relief based on the principle of "significant risk transfer" rather than the alternative pro-rata approach that imposes arbitrary tranching and percentage rules that will make capital relief dependent on the current and future methodology used by various credit rating agencies.

Other Technical Issues

14. The ASF suggests the new APS 120 acknowledge that ADIs can use contractual arrangements known as "trust-back" arrangements to achieve substantially the same result as a formal second mortgage.

15. The ASF believes that by allowing ADIs to have flexibility to structure self-securitisations with more than one B class will allow ADIs to keep existing self-securitisations structures in place and retain the ability to sell the junior notes from self-securitisations at a future point in time.

16. ASF requests that APRA clarify the transition arrangements, especially with respect to capital relief. Will ADIs that have satisfied the operational requirements for regulatory capital relief prior to the introduction of the new APS120 standard to continue to achieve capital relief for those existing securitisations.

17. The ASF welcomes APRA's proposal to review APG 120 so that "support" in the context of unfunded support will be interpreted from a substantive perspective. The ASF seeks clarification as to what, if any, considerations that will result in securitisation swaps being considered "support".

18. The ASF suggests that the definition of resecuritisation should explicitly state that use of multiple legal entities does not in and of itself create a resecuritisation. In relation to asset-backed commercial paper (ABCP) programs, the ASF does not believe that all claims in an ABCP conduit structure should be treated as resecuritisations.

19. The ASF notes that the regulatory capital treatment of senior and non-senior securitisation tranches is subject to review by BCBS following its consultation on risk weights for securitisation. We suggest any decision on the regulatory capital treatment of non-senior tranches should be deferred until the BCBS policy is finalised. However, the ASF would not be supportive of the approach currently outlined in the Discussion Paper in that any investment by an ADI in a non-senior class of a securitisation will attract a CET1 deduction.

20. The ASF believes synthetic securitisation is an important tool for portfolio risk management purposes, particularly to manage wholesale exposures on an ADI's balance sheet. ASF seeks to consult with APRA to provide a more detailed understanding on how synthetic securitisation would contribute to the real economy and enable APRA to consider clear guidelines for synthetic securitisation to ensure alignment with APRA's key principles of simplicity and transparency.

Section 1 – Date Based Calls and Master Trust Securitisation Structures

General Comments

1.1 The ASF does not believe that the APS 120 Discussion Paper (the Discussion Paper) will enable the achievement of a the following objectives:

- a substantial increase in the amount of domestic and offshore securitisation transactions issued by ADIs which will diversify their funding sources;
- increased participation from real money investors in A$ RMBS transactions;
- increased participation from offshore investors in non-AUD RMBS tranches;
- securitisation of other asset classes by ADIs, such as auto ABS and credit cards; and
- a resilient and sustainable financial system.

1.2 Without further refinement the proposed new form of APS 120 is likely to result in:

- the size of the securitisation market remaining largely unchanged and domestic in nature;
- the majority of the bonds continuing to be denominated in AUD;
- limited participation from the offshore investor base; and
- heightened systemic risk due to investor base concentration.

1.3 The ASF welcomes that APRA will allow date-based calls for funding only securitisations. As noted in the Discussion Paper, date-based calls provide a number of benefits to securitisation structures that simplify transactions, improve their marketability to investors and reduce costs and risks to issuers. However, the proviso in the Discussion Paper that the date-based call is set no earlier than the projected 10% clean-up point significantly reduces the potential value that date-based calls would provide. It would not be possible to create multiple tranches within the A class with different maturity profiles and then use date-based calls to give investors greater comfort that their tranche will be redeemed on an expected date, other than the expected 10% clean-up point. This is particularly problematic in revolving type structures, where the pool of securitised assets revolves. The ASF firmly believes that date-based calls are a key requirement if the measures of success of APS 120 set out in the Recommendations section are to be achieved. Further details in respect of date based calls are included in this section and in sections 4.21 to 4.30.

1.4 The ASF propose that Australian master trust structures be funding-only structures where ADIs hold the same capital against the mortgages being securitised post securitisation. The proposed structure will be a simple two class structure (senior tranche/A class and junior class/B class) which satisfies applicable skin in the game requirement (if any). The senior tranche will be divided into an A class held by the ADI and an A class held by investors with the two notes structured in proportions as needed. The use of date based calls, which is a key feature, will be captured in the ADI's liquidity management strategy and regulated according to prudential standard APS210.

1.5 Any triggers that end the revolving period of a securitisation prior to its scheduled termination date and stop new assets being sold into a SPV ("early amortisation triggers") will not be fundamentally different from those currently in ADI securitisation transactions and include insolvency of the ADI, an A class charge-off and servicer termination event and will lead to the notes extending as they become pass-through notes. The senior interest of the ADI in the trust assets will never be subordinated to the interest of the investors, as losses get allocated pro-rata and pari-passu at all times.

1.6 Section 2 of our submission lists the ASF's comments on the framework for date based calls and master trusts described in the Discussion Paper. This Section is structured as follows:

A. the key areas which are of particular concern to the industry in the Discussion Paper;

B. the ASF's suggested changes to the master trust framework set out in the Discussion Paper including our comment on the prudential considerations for each proposed change;

C. a comparison of the suggested Australian master trusts to the offshore master trusts; and

D. summary of answers to questions raised in our recent meetings with APRA.

A. Securitisation transactions structured in accordance with the current APS120 draft

1.7 We highlight below the key areas that are of particular concern in the Discussion Paper with respect to master trusts:

a) Amortisation of the A class seller note

The APS120 draft refers to the A class seller note and the most senior investor note class amortising at the same time. We believe that amortising the A class seller note and the A class investor notes pro-rata is acceptable pursuant to the occurrence of an early amortisation trigger but not in the ordinary course of business.

For example, it may be that cash flows are directed to the A class investor notes to fund an upcoming note maturity or that cash flows are directed to the A class seller note to absorb fluctuations in the trust. This is similar to current closed pool securitisation structures pre-default where there are multiple A class notes that can have different principal allocations (but still rank pari-passu with respect to interest payments and losses). This is a key feature that would allow efficient issuance of scheduled amortisation structures and allow for securitisation of other asset classes. Similar to the points noted above, the ASF believes that this should not be a problem for APRA provided the ADI accounts for the cash flows in its liquidity modelling.

b) Absence of date based calls

The Discussion Paper prohibits the use of date based calls other than at the forecast 10% clean up call date. This prohibits the ability to issue non-A$ tranches economically as it will not permit an ADI to reduce (but not eliminate) the prepayment uncertainty of the notes being issued.

Theoretically this prepayment uncertainty can be reduced by creating a very large A class seller note. However, the consequence of this would be to encumber a significant portion of the ADI's balance sheet for minimal funding benefit. Under one hypothetical scenario, A$500mm of funding could be raised including a A$110mm soft bullet against A$1.6bn of total encumbered assets in order to reduce extension risk down to 5% CPR in the normal course[1]. Substantial asset encumbrance could also have a negative impact on the bank's senior unsecured ratings with potential knock on consequences for their ability to issue senior unsecured debt.

In contrast, the date based call would allow the ADI to repay the outstanding amount of the notes held by the investor when not fully paid down by the expected maturity date (the ADI would then hold a greater share of the assets of the trust).

[1] Based on a structure that assumes $350mm pass through A1 notes paid in priority to the $110m A2 soft bullet notes, analysis is centered around ensuring the entire $110m of principal can be accumulated prior to the soft bullet maturity date in 5 years' time.

c) **Absence of early amortisation triggers**

The Discussion Paper addresses concerns around early amortisation triggers leading to investor's exposure being reduced early (i.e. accelerating the A class investor notes), creating a situation where the ADI would realise more losses than in a revolving phase.

Without early amortisation triggers, the master trust would not be able to amortise down upon certain events occurring such an insolvency of the ADI, servicer termination events or asset performance deterioration (i.e. A class charge-offs). When these events occur, investors would expect the A class investor notes to become pass-through securities. Lack thereof would result in investors becoming time subordinated vis-a-vis the A class seller note held by the ADI, which is not something institutional investors will accept.

d) **Revolving assets**

The Discussion paper does not address revolving assets such as credit cards where there is a requirement to continue funding the credit cards on an ongoing basis even, for example, post an early amortisation event. We would like to propose to continue discussions with APRA in relation to revolving assets and how they will be treated in the new APS 120.

B. Proposal for allowing for a viable and prudentially sound master trust structure

1.8 We would like to continue to discuss with APRA the development of a framework for securitisation structures that will create a more resilient financial system. This will be achieved by creating a deep and liquid securitisation market which will be used by ADIs to raise funding globally.

After consulting with the industry, the ASF proposes the following 3 key features be included in APS120 in order to ensure viable master trust issuance:

a) **A class seller note**

One of the key advantages of master trusts is the ability to structure soft-bullet and scheduled amortisation notes which reduce (but do not eliminate) extension risk. In a typical master trust, the ability to meet A class investor soft-bullet and scheduled amortisation note obligations are supported by the principal collections from all the assets in the trust. Creating soft-bullet and scheduled amortisation notes will attract a broad investor base when issuing foreign currency denominated notes.

The revolving nature of the A class seller note (i.e. revolving periods) is a concept which already exists today in securitisation transactions (see Crusade Auto programme as an example). In addition to the A class seller note revolving, we anticipate it would move up or down much like a variable funding certificate prior to the occurrence of an early amortisation trigger. This note will not necessarily move in line with the A class investor notes (i.e. ability to direct cash).

However, the A class seller note will always rank pari-passu with the A class investor notes with respect to payment of interest and allocation of losses. Upon the occurrence of an early amortisation trigger, this A class seller note would then rank pari-passu with respect to principal and pay down at the same rate as the A class investor note.

Principal would only be directed to the A Class investor notes in the normal course of business

Prior to the occurrence of an early amortisation trigger, all assets in the trust will be used to accumulate cash as required for the A class investor scheduled amortisation and soft-bullet notes. However, after an early amortisation trigger, the A class seller note and the A class investor notes would be repaid pro-rata and pari-passu.

The A class seller note would only revolve in the normal course of business

During the normal course of business the pool of assets will revolve and the ADI would look to sell more assets into the trust to enable further funding. The ADI is however not obliged to sell more assets in the trust. Not selling further assets will stop the ADI from being able to issue further A class investor notes as there might not be sufficient assets in the trust to back those notes. After an early amortisation trigger occurs, the ADI cannot sell any further assets into the trust.

b) Date based calls

The date based call is a key feature when structuring scheduled amortisation and soft-bullet notes in residential mortgage master trusts, since it reduces (but does not eliminate) extension risk for investors. They can also reduce the amount of assets that an ADI would have to sell to a master trust in order to fund scheduled amortisation and soft-bullet notes.

Exercising the date based call results in the ADI facilitating repayment of the notes at the expected maturity date either by refinancing such notes with subsequent offerings, or by contributing cash and in obtaining as consideration a corresponding increase in the A class seller note.

Exercising the date based call is at the ADI's option:

Not calling the A class investor notes would result in an extension of the notes (the investor's risk) but not an event of default of the notes. The scheduled amortisation and soft-bullet notes become pass-through notes when not called.

Date based calls can no longer be exercised upon early amortisation triggers occurring:

An insolvency of the ADI, charge-off of A class notes and servicer termination event would be early amortisation triggers that end the revolving period of a securitisation prior to its scheduled termination date and stop new assets being sold into a SPV, leading to the trust entering into amortisation which would result in all A class notes becoming pass-through notes and principal getting allocated pro-rata and pari-passu between the A class seller notes and the A class investor notes. This effectively ensures that the date based call can no longer get exercised once an early amortisation trigger has occurred and hence the A class investor notes can no longer get paid down ahead of the A class seller notes. All notes will get paid down entirely through the cash flows generated by the trust.

Date based call liquidity requirements captured within APS210:

We would propose that the liquidity requirements of the ADI in relation to the date based call be captured within the ADI's liquidity management strategy and regulated according to prudential standard APS210.

Not exercising the date based call would not create additional risks/stresses for an ADI:

As an alternative to exercising the date based call, the ADI could reissue the notes to existing or new investors. Failure to do so, would result in an extension of the notes which we do not believe would preclude the ADI from issuing in the future (i.e. investors might revert to investing in pass-through structures only which do not rely on date based calls or they might price the note to maturity date rather than to the call date). In fact, we believe that in some circumstances, it would be more prudent of the ADI to meet its other obligations first where a redemption deferral is not an option. Liquidity put aside for the call could be used to redeem those hard bullets (i.e. senior unsecured).

c) Early amortisation events linked to asset and non-asset triggers

Early amortisation triggers will stop the pool from revolving (i.e. no further assets are sold into the trust) and the master trust starts amortising. Early amortisation triggers are an insolvency of the ADI, servicer termination events and asset performance deterioration (i.e. A class note charge-offs). We would not propose any triggers based on the financial performance of the originating ADI (except for insolvency).

When these events occur all A class notes (both A class seller notes and A class investor notes) are to be repaid on a pass-through basis.

The waterfall post an early amortisation trigger would specify the way in which the notes (both the A class notes and the B class notes) amortise. We propose for principal to get allocated pro-rata and pari-passu between the A class seller note and the A class investor notes post an early amortisation event. This effectively ensures that the A class investor notes are not paid down ahead of the A class seller notes.

Early amortisation events lead to pro-rata allocation of principal

When the trust starts to amortise the A class seller note and the A class investor notes are repaid pro-rata and pari-passu.

An occurrence of an early amortisation trigger will lead to no further assets being sold into the trust

For non-revolving assets, no further assets are sold into the trust and all notes are repaid with the cash flows of the existing assets in the trust.

In addition to the prudential considerations highlighted above in relation to the specific proposed features, please also find further general prudential considerations:

Losses

The A class seller notes will never be subordinated to the A Class investor notes. Throughout the life of the transaction (pre early amortisation event and post the occurrence of an early

amortisation trigger), losses are always shared on a pro-rata basis between the A class investor notes and the A class seller notes.

Importantly, investors do share in a substantial amount of losses through getting allocated a pro-rata share of losses both in the normal course of business and during amortisation.

Master trusts are funding only transactions

While the ADI benefits from the fact that some risk transfer occurs in master trusts, being a funding-only transaction, the amount of capital held by the ADI will not change versus the capital requirement if the mortgages were held on balance sheet. The ADI is holding capital against all assets in the master trust. Hence a changing proportion of interest held by the ADI in the assets of the master trust (i.e. A class seller notes going up or down) does not impact the capital position of the bank.

APRA oversight

We would expect APRA to retain oversight of master trusts. This could include APRA determining whether or not date based calls should occur, or whether an early amortisation trigger should occur.

C. Comparison of proposed Australian master trusts to offshore master trusts

1.9 The key differences between the proposed Australian master trusts and offshore master trusts are as follows:

a) Principal allocations following the occurrence of a non-asset trigger (i.e. seller insolvency)

In the UK, after a non-asset trigger, the Bank of England allow principal allocations to be made first to the investor share, followed by the seller share. A non-asset trigger typically includes a) insolvency of the seller, b) the current servicer ceasing to be the servicer (and a replacement cannot be found), c) the seller share falling to less than the minimum seller share and d) the trust size falling to less than the minimum trust size (if any).

Losses are allocated on a pro-rata basis depending on the relative balances of the seller share and investor share at the time in which the loss is realised.

In the US and Canada, a similar acceleration of the investor share applies, master trusts, which are primarily used to fund credit card receivables, allow for “fixed allocation” to occur in the event of early amortisation (which can be linked to both asset and non-asset triggers).

Under a fixed allocation, principal collections are allocated to the investor share based on a percentage which is fixed at the time at which the event occurs, for example if the investor share was 90% at this time, the investor share would receive a minimum of 90% of principal collections. Since some assets (such as credit cards) have ongoing funding obligations, in many instances, the seller share is required to continue funding new receivables (after an early amortisation event), this leads to the seller share increasing over time while continuing to receive a lower percentage (e.g. 10%) of principal collections.

b) Rights of investors upon an Event of Default (EOD)

In both the US and UK, after the occurrence of an EOD, investors cannot take possession of the entire pool of underlying assets, instead, they are only able to sell their interest in the master trust. In the US, investors can liquidate their pro-rata share of assets in the securitisation vehicle once the legal final maturity date occurs (provided the majority of creditors agree on the sale). In the UK, investors can get collectively agree to sell the investor share in the master trust, but not the underlying assets.

D. Questions and answers arising from recent ASF – APRA meetings

a) Why is the proposed Australian master trust structure not a covered bond?

i. There is no dual recourse with master trusts, i.e. there is no recourse to the ADI, the recourse of investors is limited to the assets of the pool only;

ii. A clearly defined structure is created with respect to the ordering of principal repayments both in the normal course, following early amortization trigger events and following an event of default;

iii. Investors participate in losses pre and post early amortisation trigger events as losses are shared pro-rata and pari-passu between A class seller notes and the A class investor notes;

iv. There is no requirement to continue adding assets into the trust;

v. There is no requirement to substitute poorly performing assets with performing assets; and

vi. There is no obligation to exercise the date-based call. Not exercising the call, does not lead to an event of default of the notes (notes become pass-through securities if the notes are not called).

b) What are the liquidity risks for the ADI throughout the life of the Australian master trust

As noted previously, the decision to exercise a date based call is at the discretion of the ADI and is not a legal obligation. However, it would be prudent for an ADI to assume that it will exercise the date based call when considering its liquidity position. In that scenario, the ADI will have an outflow equal to the amount of notes outstanding at the time of, and subject to the date based call, this is different from a traditional pass through securitisation where the outflows would be more gradual reflecting the cash flows of the underlying assets. Therefore, in recognition of a more lumpy cash flow profile it is to be expected that when modelling its liquidity position an ADI will include this outflow in its cash flow projections and this will flow through to prudential limits such as maximum maturities within any period and the LCR.

A date based call included in RMBS transactions would be treated under APS210 as a date based call. The ability to include date based calls in securitisation structures will enable greater term securitisation issuance by ADIs due to their ability to reduce (but not eliminate) extension risk, a key requirement for many offshore and domestic investors. The ADI could then use the proceeds to pay down shorter tenor funding improving the liquidity profile of the ADI. In addition, not having date-based calls could actually lead to a large liquidity outflow, if an ADI has to accumulate a large amount of cash to fund a bullet and is holding that cash itself, if that ADI was subsequently downgraded the cash account would have to be moved, leading to a large cash outflow. Finally, we note that APRA has oversight of each ADI's liquidity position through APS210 and has the ability to prohibit the exercise of the call if it feels that the ADI's liquidity position is not sufficiently robust.

In addition to date based calls, liquidity modelling will also need to look at expected repayments on the A class seller notes. As outlined earlier in this paper, there will be instances where cash flows are directed to the A class investor notes to fund an upcoming note maturity or where cash flows are directed to the A class seller note to absorb fluctuations in the trust.

c) How many assets (size of A class seller notes relative to A class investor notes) need to be encumbered under various CPR scenarios to structure soft-bullet notes without date based calls

Taking an example of a $0.5bn trust (with no seller share if date based calls are allowed). If the 5 year soft bullet note is 22% of the Class A investor share, the table below shows the required size of the total trust (i.e. encumbered assets) under different CPR scenarios[2].

CPR	Encumbered assets
0%	$5.0bn
5%	$1.6bn
8%	$1.2bn
10%	$1.0bn

d) Are there any examples of notes issued with date based calls by major institutions which were not called and what was the impact on those institutions?

There are a number of examples in the European ABS/RMBS space:

- Netherlands: Delta Lloyd, ABN and Fortis.
- Spain: Santander and BBVA.

[2] Based on a structure that assumes $350mm pass through A1 notes paid in priority to the $110m A2 soft bullet notes, analysis is centered around ensuring the entire $110m of principal can be accumulated prior to the soft bullet maturity date in 5 years' time.

- UK: Paragon, Coop/Britannia.
- Portugal: BES, BCP, BANIF.

Each of these issuers has since come back to the market with a number of successful ABS/RMBS offerings (albeit at a higher cost to the ADI due to investors pricing in the lack of certainty around future calls).

Beyond ABS/RMBS, Deutsche Bank was the first major bank not to call their subordinated notes. This caused a general market reaction in terms of demand for their paper and had implications on their future deals (in terms of pricing). However it did not restrict them from future issuance. A number of other banks then followed suit (including BBVA and Santander), in some cases liability management alternatives were offered and in all cases, the impact of not calling was not substantial.

e) What are the implications of date based calls for depositors?

Date based calls would be positive for depositors for three main reasons:

i. Similar to the point raised above, date-based calls will enable ADIs to improve their liquidity profile making ADIs more resilient to times of stress;

ii. In a stress scenario, given that the call is an option of the ADI it could choose not to exercise the call in order to be able to fund other maturities that are coming due at the same time where the ADI may not have that option. The structure would then likely revert to a simple pass through structure further reducing the outflows going forward;

iii. Without date based calls ADIs are likely to have to encumber significantly more assets to raise the same amount of term funding.

The ASF accepts APRA’s position that Master Trusts including date based calls would be funding-only issues and no capital relief would be achieved, which does not adversely affect depositors.

f) What are the implications for APRA's focus on resolvability issue?

The Northern Rock/Granite programme is a good example of what can happen to a securitisation structure in a scenario where the ADI is subject to an event that requires resolution. In this scenario, Northern Rock was required to be nationalised following a requirement to seek emergency funding from the Bank of England. At the time, it had a large RMBS master trust programme (Granite) which had a number of notes outstanding that had date based calls attached to them. The master trust programme went into amortisation and effectively became a large, closed pool programme and the notes issued became pass through notes that have not been exercised on their call dates but have amortised in line with the underlying mortgages in the pool, significantly reducing the potential stress on Northern Rock from having to meet large outflows at the call dates. The programme performed exactly as expected and investors accepted that the repayment profile of their investments would be extended.

g) What are the implications of date based calls for systematic sustainability?

On balance, the ASF does not believe that date date-based calls would create additional stresses for an ADI if they could not fund the call. The structures could contemplate the ability to reissue the notes so if existing investors or new investors wanted to be rolled into new notes they could be. If this is not possible, we do not believe that a failure to fund a call would be seen by the market as a point of non-viability in itself, if an ADI is in financial difficulties then it is likely to have a number of different liabilities coming due and having the ability to defer redeeming the securitisation notes would actually be a benefit as the ADI could use the liquid assets it would have had to put aside to fund the call to then meet other obligations where the ADI does not have the option but must redeem. Longer term, as has been seen from a number of issuers, not exercising a call does not shut an issuer out of the market completely. Instead, investors are either likely to ask for simpler, pass through structures or not price to the call date going forward.

h) Date based call options should not be a disguised put

Much like the current requirements with APS120 around disclosure to investors such as noting that the securitisation notes are not liabilities of, or deposits in the ADI, the new standard could prescribe that an ADI includes clear language in the offering document that states that the exercise of the call option is entirely at the discretion of the Issuer and in no circumstances would the failure to exercise the call give investors any rights to require the notes to be redeemed other than through receiving cash flows from the underlying assets.

Section 2- Securitisation Warehouse Arrangements

2.1 Some originators of assets (both ADI and non-ADIs) use private funding arrangements – generally referred to as "warehouse arrangements" – provided by one and occasionally more than one ADI to aggregate pools of assets before refinancing them via a placement of securities to a more diverse and broad range of capital markets investors. In this way, warehouses are a simple, usually bilateral, funding arrangement which facilitates the aggregation of assets in a Warehouse SPV until a point where both (a) there is a sufficient pool of assets and (b) it is economically feasible to place securities to investors.

2.2 The ASF welcomes APRA's recognition that warehouse arrangements promote more efficient access to securitised funding for ADIs and non-ADIs. Warehouse arrangements have played a meaningful role in the Australian securitisation market for a number of years and continue to be utilised by both ADI and non-ADIs for a wide range of assets including residential mortgages, auto and equipment loans and consumer loans. The provision of warehouse funding to both ADI and non-ADIs supports lending to the real economy and promotes financial stability and competition. In addition, the ASF believes that the provision of warehouse funding can be aligned to APRA's objectives for the reform of the prudential standard for securitisation.

Definition of a Warehouse Arrangement

2.3 In principle the ASF agrees with the generic definition of 'Warehouse SPV' in the Discussion Paper. In the normal course, warehouse arrangements are used as funding arrangements in relation to the underlying assets before the issuance of securities to the market. However, as noted above, warehouse arrangements are generally structured to provide the borrower with certainty of funding during the agreed availability period. Whilst they can be refinanced via term securitisation issuance to capital markets investors they are arrangements which do remain on foot and form part of an ADI's or non-ADIs overall funding plan.

2.4 The Discussion Paper notes traditional securitisations require the term of funding to match the term of the underlying asset and states that this is not achieved with a warehouse structure. The ASF notes that this working assumption is not true for the many warehouse arrangements that are structured so that the term of the funding is matched to the term of the underlying assets. Although the availability period for drawing upon a warehouse facility may be short term, the maturity date of the notes matches the maturity of the assets. The ASF believes that in line with APRA's approach for APS 120, the regulatory treatment should follow a principles based approach recognising substance over form such that the treatment of these types of warehouse arrangements should follow that of a term securitisation.

2.5 The ASF requests clarity from APRA on whether "warehouse arrangements" under the revised APS 120 will be limited to funding arrangements which involves an asset and liability mismatch.

2.6 The above example and the fact that warehouse arrangements for different types of assets can be structured in very different ways makes defining a standard 'warehouse arrangement' very difficult. However, the ASF strongly believes that the mere fact that a transaction is

labelled a "warehouse" should not drive its capital treatment and that this would be inconsistent with a principles based approach.

2.7 The ASF would appreciate the opportunity to consult with APRA ahead of the next securitisation consultation paper on warehouse arrangements. The ASF believes this consultation could provide APRA with a more detailed understanding on how warehouse facilities are structured and enable APRA to consider whether specific warehouse rules are required at all. Alternatively it may consider the need for a reformulation of the rules for warehouse arrangements based on their substantive structures rather than their purpose. The ASF trusts that this is consistent with APRA's desire for the revised APS 120 to be a principles, rather than rules, based standard.

Clarification on rationale for specific rules for warehouse arrangements

2.8 Given the challenge in accurately defining a warehouse arrangement, the ASF requests clarification from APRA on the rationale for placing separate rules for warehouse arrangements. This approach appears inconsistent with the Basel Committee on Banking Supervision ("BCBS") securitisation framework. In addition, as noted above, the ASF believes that an attempt to define a warehouse arrangement based on its purpose rather than its substance is inconsistent with the objective of a simplified principles based approach to APS 120.

2.9 The ASF understands APRA's concerns with any securitisation arrangement which results in capital leakage from the banking system. The ASF also understands that, in certain circumstances, the current APS 120 may result in a reduction in risk capital where an originating ADI obtains capital relief via a warehouse and the securitisation exposures of the warehouse provider to the Warehouse SPV carry a lower risk weight than the assets transferred to the Warehouse SPV by the originating ADI. However, this outcome only occurs under the current APS 120 where the warehouse provider provides 100% funding against residential mortgages which carry 100% lenders mortgage insurance.

2.10 However, this is in fact not the case for any tranched securitisation warehouse arrangement where the ADI warehouse provider holds the senior notes and the junior note is retained by the sponsor (originating ADI) or sold to a third party investor. In addition, there are many warehouses in existence where the originating ADI does not seek capital relief for the warehouse arrangement.

2.11 As such from a capital perspective, under a funding-only warehouse securitisation there is no capital leakage from the banking system. In fact, the regulatory capital in the banking system increases during the warehouse phase under a funding only securitisation. While there is no change to the amount of capital held by the originating ADI, warehouse providers are required to hold capital against the warehouse arrangement. This is shown by way of the following example: assume the underlying assets are residential mortgages originated by a standardised ADI, and seeks warehouse funding from a non-related third party ADI.

	Pre-securitisation RWA	Post-securitisation (funding only) RWA	% increase in RWA Pre and Post-securitisation
Originator	35%	35%	0%
Warehouse provider (non-related ADI)^	0%	7%	Large %
Total RWA	35%	42%	+20%

^ *APRA has confirmed the warehouse funder may treat the funding as a securitisation under APS 120 and assuming an externally rated 'AAA' exposure to senior notes*

2.12 The capital post-securitisation has increased as a result of the warehouse provider holding capital for the warehouse funding it provides. Alternately, assume the originator was a non-ADI, pre-securitisation the regulatory capital held in the banking system in relation to the underlying assets would be nil, and increase by the amount of capital that the ADI warehouse provider holds against the warehouse funding. The ASF also notes that the BCBS is currently reviewing risk weights for securitisation exposures and the hierarchy of approaches. It is not possible for the ASF to comment definitively on this point until the BSBCS consultation is complete and the BCBS has published its final rules with respect to the revised risk weights.

2.13 From a liquidity/funding perspective, if APRA's concern requiring separate warehouse rules relate to an ADI's refinance or rollover risk, ASF believes this is addressed through liquidity requirements introduced under APS210 (Liquidity). In relation to the refinance risk remaining with the originating ADI, under APS210 that ADI must calculate liquidity requirements based on the earliest date funding may be required. In the case of a warehouse arrangement this would be the maturity date of the warehouse. For warehouses that are structured so that the term of funding matches the term of the underlying asset, the liquidity risk is eliminated in much the same way as a public term securitisation (subject to the clean-up call).

2.14 In a warehouse arrangement provided by an ADI to another ADI, the funding ADI will factor in the rollover risk in its overall funding plans in the same way it would for other lending arrangements unless the arrangement is structured in such a way that the refinance risk remains with the originating ADI. The ASF welcomes APRA's decision to explicitly link the revised APS 120 with the requirements of APS 210.

Funding-only vs capital relief securitisations

2.15 APRA has raised concerns of capital leakage if warehouse assets are not funded through a term securitisation. As outlined above, the ASF believes this is only relevant for warehouse arrangements where the borrower is an ADI which has obtained capital-relief in respect of the assets transferred to the Warehouse SPV. Historically, the availability of capital relief for warehouse arrangements has required additional rules, and complexity, to be incorporated into the wording and interpretation of the current APS 120.

2.16 For the reasons outlined below, the ASF proposes that capital relief should no longer be permitted for warehouse arrangements unless specific conditions are met. The ASF outlines those conditions below:

- the tenor of the funding at least matches the tenor of the assets (i.e., unless the originating ADI can demonstrate that their warehouse arrangement is essentially a term securitisation, then the originating ADI would not be able to claim capital relief for that securitisation arrangement;
- significant risk transfer is achieved, i.e. the B Notes have been sold to an unrelated third party;
- the Originating ADI is not involved in the extension of a revolving period where terms can be amended, e.g. pricing; and
- the revolving period has ended (aligned to revolving master trusts which are funding only transactions).

2.17 This is consistent with the principle that the regulatory capital treatment of a securitisation should follow its substantive structure rather than its form or purpose. The implication is that there is no change to the regulatory capital held by the originator pre- and post-securitisation (i.e., there is no capital leakage from the banking system) and liquidity requirements remains with the originating ADI (as described above).

2.18 Limiting capital relief for a warehouse arrangement as stated above is aligned with APRA's view that warehouse arrangements should be temporary in nature. For those ADIs seeking capital relief, the incentive to term fund the assets is greater when that is the only way to achieve capital relief under the revised securitisation prudential framework.

2.19 The ASF does note that there are certain instances where some assets, for example, trade receivables, are funded by ADIs with no intention for those assets to be refinanced via the term capital markets. These assets are short dated (generally less than 90 day exposures) which self-liquidate. Whilst these assets may be funded via a Warehouse SPV, securitisation technology is effectively only used to provide that sponsor (in the case of trade receivables, a non-ADI) with a secured funding arrangement. ASF believes securitisations for assets with a legal tenor of less than 12 months should be specifically excluded from any rules regarding warehouse arrangements.

Two-tranche structure

2.20 The ASF also supports APRA's proposal to require at least two tranche structures for warehouse arrangements. This aligns warehouses to the proposed APS 120 securitisation definition, the BCBS securitisation framework and the objective to simplify and remove multiple rules specifically for warehouse arrangements.

2.21 Based on APRA's credit risk retention proposal where the originating ADI holds a portion of subordinated notes, unless there are third parties investing in subordinated notes in the warehouse arrangements, ADIs will likely not be able to achieve concessional capital outcomes.

12 month requirement to refinance warehouse arrangements

2.22 The ASF understanding of APRA's rationale proposal for a 12 month refinance requirement on warehouse funding is to prevent the leakage of capital from the banking system. As has been outlined above, the leakage of capital from the banking system potentially only occurs in a very limited subset of warehouse arrangements. The ASF is of the view that a prohibition against originating ADIs obtaining capital relief for warehouse arrangements where the tenor of the funding does not at least match the tenor of the assets is a more targeted solution to the issue.

2.23 The 12-month refinance requirement raises a number of issues and points of clarification that are outlined below:

- in providing funding to non-ADIs, the 12-month requirement is inconsistent with other APRA standards such that an ADI providing secured funding to a non-ADI under APS112/113 does not have a corresponding refinancing (including tenor) requirement;
- the decision to term out assets remains with the originator. This is a function of both the volume of assets in its warehouse(s) and the conditions of the term capital markets. Therefore imposing additional regulatory capital on the warehouse provider does not appear to align with the party that controls the assets and the party with primary responsibility for refinancing the assets funded by the Warehouse arrangement (i.e. the originator);
- in a stressed market when the capital markets are closed and assets cannot be refinanced within 12 months, imposing extra regulatory capital at a time of stress is counter-cyclical. The ASF does not consider a counter cyclical capital charge to be prudent in a period of market-related stress. Capital charges imposed against the securitisation exposure are already calibrated for credit and non-credit risk related features of the exposure;
- under APS 120, foreign ADIs are not regulated by APRA for capital purposes and therefore the 12 month warehouse rule may cause domestic ADIs who provide warehouse facilities to be less competitive on their pricing of such facilities. An unintentional consequence is that this may shift warehouse funding to foreign ADIs and leave domestic ADIs uncompetitive. If this were to occur this would bypass APRA's objectives for warehouse funding arrangements;
- monitoring the movement of assets by date from the originator to a warehouse, and between warehouses, is practically impossible. No originator actively monitors assets in such a way, and implementation of this requirement would be highly complex, difficult to govern compliance and cost prohibitive;
- term securitisations may fund assets that are in a number of warehouses which means there would be some assets remaining in multiple facilities for a period greater than 12 months. Practically, no warehouse arrangement is entirely refinanced via a term securitisation;
- no specifics have been provided on whether the rule applies on an asset-by-asset basis or on a total portfolio basis;
- the 12 month period is arbitrary and not consistent with a principles based prudential regime. There are a number of ADI sponsors who genuinely require more than 12 months

to build an asset pool for refinance via the capital markets. The proposal in its current form adversely affects smaller ADIs;

- non-ADIs are not required to hold risk weighted capital against their assets so the provision of warehouses to them does not result in any capital leakage from the banking system and as such the ASF does not believe that it is justifiable to apply the requirement to non-ADI sponsors. Non-ADI sponsors would be disproportionately impacted by the provision of the 12 month refinance period which imposes capital penalties for the warehouse provider. The provision of this arbitrary rule would potentially impact the ability of non-ADIs to obtain cost effective and efficient warehouse funding prior to conducting the term securitisation. If this was the case this would have negative implications on the business models of many non-ADI mortgage lenders and hence reduce competition in the market. It also provides a barrier for new non-ADI participants to enter the market because of the requirement to refinance warehoused assets into the term securitisation markets within 12 months of origination (which is unrealistic for a new business);
- when the underlying assets of a securitisation are performing, there should be no capital impost for market related conditions. Assuming APRA adopts BCBS' proposed approach to risk-weights, maturity will be factored into the risk-weight for the underlying securitisation exposure. ASF believes imposing additional capital for holdings longer than 12 months would be a 'double counting' of capital. However ASF notes that a comprehensive feedback on the proposed 12 month rule can only be provided following a review of APRA's proposed risk-weights for securitisation exposures;
- the Discussion Paper refers to residential mortgages in the warehouse section and is silent on other assets classes. Will the 12 month rule apply to other asset classes as well?

2.24 In light of the above issues and given that the ASF recommends warehouse arrangements be available for funding-only securitisations unless the substance of the funding arrangement mirrors that of a closed pool matched funded arrangement, the ASF believes any concerns APRA may have of regulatory capital leakage and/or liquidity are mitigated. As such ASF recommends the abolishment of the 12-month requirement.

2.25 It is the ASF's view that the imposition of a 12 month refinancing requirement where capital charges are imposed on ADI Warehouse providers post a 12 month period will materially impact the provision of warehouse funding. This would in turn reduce credit to both ADI and non-ADIs with a flow on reduction in credit to the real economy and competition from smaller ADIs and non-ADIs.

Representations and Warranties to repurchase or replacement of exposures out of the pool

2.26 While in general there is an intention to align representations and warranties from warehouse transaction documents to those that appear in term transactions, it is difficult to agree representations and warranties for future circumstances with an unknown pool composition, unknown investors and unknowable future market expectations (especially as a warehouse supplies assets into term securitisations a number of years after the warehouse was first established).

2.27 APRA noted that in the event R&W's do not change from warehouse to term deals there would be fewer "assets being ineligible for term issuance". The pool composition of a term securitisation issue is largely driven to maximise investor appeal. Certain loans may fall into arrears, and while those loans were eligible upon sale into the warehouse, those assets are generally ineligible for term securitisations.

2.28 It is important to bear in mind that there are two types of loan representations - those that relate to the origination of the loan and those that relate to the performance of the loan at a particular time (initially, as at the sale by the originating ADI to the warehouse). Examples of the former are that the loan was originated in accordance with the normal origination guidelines of the originating ADI, that at the time of origination the obligor was not known to be insolvent and that the loan was fully drawn on origination. Examples of the latter are that the loan is not more than 30 days in arrears at the relevant time, that the loan was serviced in accordance with the normal servicing guidelines and that the servicer/seller is not aware that the obligor is insolvent at the relevant time.

2.29 In the case of the latter types of representations, these can be tested as at the time of sale from warehouse to term securitisation, and should be given by the servicer/seller at that time (whether or not they were given by the originating ADI at the time of the original sale to the warehouse). [In the case of the former, these can be dealt with by assignment by the warehouse trustee to the term trustee, and would not need to be repeated.

Clean-up calls

2.30 Clean-up calls are an integral feature to any securitisation arrangements. The absence of clean-up calls from warehouses presents a practically difficult position of not being able to terminate and close a warehouse arrangement. For the same reasons that call dates are needed for term deals, a clean-up call mechanism for warehouses is required to provide the option to remove the remaining assets from the securitisation SPV. This is a function of how warehouse arrangements are structured and utilised in the Australian market.

2.31 As such, ASF requests clean-up calls are permitted for warehouses> In particular, where there is no capital relief and the tenor of the funding at least matches the tenor of the assets. From a liquidity perspective APRA has acknowledged clean-up calls within ADIs liquidity requirements. This should provide APRA comfort that appropriate capital and liquidity is held by the originating ADI in any warehouse.

Section 3 - Determination of Capital Relief and Risk Retention

Securitisation for capital relief – significant credit risk transfer or pro rata approach

3.1 APRA has invited submissions on the merits of maintaining the current approach under APS 120 (that significant credit risk must be transferred for the originating ADI to achieve capital relief) or adopting the proposed new "pro rata" approach.

3.2 The ASF submits that it is difficult to provide meaningful comment on the respective merits of the alternative approaches until further detail and clarification is provided by APRA regarding the proposed operation of the two approaches.

3.3 In particular, the ASF would appreciate further detail regarding certain aspects of the significant credit risk transfer approach. For example, as APRA has stated that the alternative capital treatment approach would cease from the date of the revised APS 120,[3] it would be helpful to understand if APRA intends that the significant credit risk transfer approach will involve an all or nothing outcome from a regulatory capital perspective. That is:

a) if significant credit risk transfer occurs, the originating ADI would obtain a 100% reduction in capital requirements associated with the underlying assets (or, does APRA intend that capital relief would be also capped at 80% under this approach?); and

b) if significant credit risk transfer does not occur, the originating ADI would obtain no capital relief.

3.4 If an all or nothing outcome is not intended, please could APRA provide further details regarding how the regulatory capital outcome is to be determined.

3.5 If APRA is proposing that the originating ADI be required to retain at least 20% of the B class securities in its securitisation (that is, pursuant to the skin in the game requirements proposed by APRA), it is not clear to the ASF whether such holdings of the B class securities would prevent the originating ADI from satisfying the significant credit risk transfer approach (but, based on prior guidance from APRA, the ASF is of the view that would almost certainly be the outcome unless APRA has subsequently modified its view in this regard).

3.6 The ASF would appreciate an opportunity to engage with APRA to develop detailed guidelines that would provide clear guidance to originating ADIs in determining whether significant credit risk transfer has occurred (with such rules taking into account compliance with its skin in the game obligations), with a view to mitigating the risk that ADIs incorrectly interpret the criteria needed to be satisfied to achieve capital relief. For example, the ASF submits that greater certainty would be achieved by the inclusion of more detailed guidelines similar to those applying in Europe pursuant to Article 243 of Regulation (EU) No 575/2013 of the European Parliament and Council (the "CRR"). Whilst the ASF supports APRA's "*more principles-based than rules-based"* approach generally, the ASF submits that in certain limited instances (such as determining whether significant credit risk transfer has occurred) more detailed guidelines can enhance the overall operation of the prudential standards. Accordingly, APRA submits that if the significant credit risk transfer approach is adopted (rather than the pro rata approach) APRA should consider the inclusion of significant credit risk transfer rules similar to those contained in Article 243 of the CRR. Provided that such guidelines were to be

[3] Page 17 of the Discussion Paper

introduced, the ASF would support the significant credit risk transfer approach in preference to the pro rata approach.

3.7 Under the pro rata approach, it is not clear to the ASF why the calculation of capital relief is linked to the largest proportional holding in the sub-classes of subordinated securities. The ASF submits that such an approach over emphasises the merits of simplicity, is not sufficiently risk sensitive and has the potential to result in capital relief outcomes that have limited correlation to the risk retained by the originating ADIs. Further, the ASF notes that such linkage has the potential to result in capital relief outcomes being dependent on rating agency methodology, to the extent such methodology is a determining factor in the sizing of tranches of subordinated securities.

3.8 For example, assume the following:

- Total pool size of $100.
- Two classes of B class securities, B1 of $5 and B2 of $3.
- The B2 class represents the first loss tranche and therefore the most risk.

Case 1

- The originating ADI holds 20% of the B2 securities and 50% of the B1 securities.
- The originating ADI is entitled to 50% capital relief.

Case 2

- The originating ADI holds 50% of the B2 securities and 20% of the B1 securities.
- The originating ADI is entitled to 50% capital relief.

In both Case 1 and Case 2 the originating ADI is entitled to 50% capital relief, despite the difference in risk profile. That is, under Case 2 the originating ADI is exposed to significantly greater risk (by holding 50% of the B2 first loss tranche) than under Case 2, yet it is entitled to the same capital relief outcome.

3.9 Also, the capital relief outcome under the pro rata approach has the potential to be distorted by relatively small tranches of sub-classes of B class securities. Again, by way of example, assume the following:

- Total pool size of $100
- Three classes of B class securities, B1 of $0.5, B2 of $5 and B3 of $3.
- The B3 class represents the first loss tranche and therefore the most risk.

Case 1

- The originating ADI holds 20% of the B3 securities, 20% of the B2 securities and 50% of the B1 securities.
- The originating ADI is entitled to 50% capital relief.

Case 2

- The originating ADI holds 20% of the B3 securities, 20% of the B2 securities and 100% of the B1 securities.
- The originating ADI is not entitled to any capital relief.

In both Case 1 and Case 2 the originating ADI is exposed to substantially the same credit risk as the B3 class represents (given historical losses) substantially all of the risk in the transaction, yet very different capital relief outcomes result for the originating ADI.

3.10 Under the pro rata approach APRA has capped potential capital relief at 80%. This appears to be linked to the credit risk retention requirement (discussed below) of 20% of each sub-class of junior notes. It is not clear to the ASF why capital relief is capped at 80% and why APRA appears to be proposing a linkage between the concepts of skin in the game and capital relief. The ASF submits that the assessment of capital relief should be risk sensitive (and should not therefore be capped at 80%[4]) and that the issues of capital relief and skin in the game should be de-linked and treated as a separate issue (that is, the objective of better aligning the interests of originators and investors can be met without regard to a risk sensitivity analysis of the securitisation exposures retained by the originating ADI).

Credit risk retention (skin-in-the-game)

3.11 The ASF notes that APRA is proposing to implement a credit risk retention requirement, by requiring that an originating ADI retain at least 20% of the junior class in each of its securitisation structures.[5] The stated purpose of such retention requirement is to better align the interests of originators and investors.

3.12 The ASF welcomes, and agrees with, APRA's observations that the quality of securitisations issued by ADIs in Australia was generally strong and the quality of ADI residential mortgages backing RMBS issues in Australia was generally strong before and during the crisis. Accordingly, the ASF submits that whilst there is limited (if any) evidence of material "agency risk" (of the type experienced in other jurisdictions, in particular the United States) in the Australian market, the ASF acknowledges the developments of credit risk retention requirements in other key jurisdictions (in particular, Europe and the United States) and fully supports appropriate regulatory reform where required to improve investor protection and to promote an efficient, well-functioning and liquid securitisation market in Australia.

3.13 However, the ASF also notes that the original IOSCO report did not mandate any particular approach to credit risk retention. Whilst jurisdictional differences in the implementation of risk retention requirements may exacerbate the difficulty in efficiently structuring a securitisation transaction that is compliant with the skin-in-the game requirements in all key relevant jurisdictions, the ASF notes that certain material differences already exist between the US and the European risk retention rules which require the adoption of a "lowest common denominator" approach. In addition to the goal of harmonisation, mutual recognition between key jurisdictions of different risk retention regimes would appear to be optimal means of resolving this issue.

3.14 Furthermore, as outlined in joint Discussion Paper titled "The case for a better functioning securitisation market in the European Union" issued by the Bank of England and European Central Bank in May 2014, the case for formulating a special set of rules for "qualifying

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[4] The ASF notes that such a cap would not be consistent with the approach taken under the Basel securitisation framework

[5] Page 15 of the Discussion Paper

securitisations" is under consideration. The proposed US risk retention rules exempt securitisations of "qualifying mortgages" and "qualifying residential mortgages" from their scope. Although such an exemption has not yet been contemplated under the European proposals, the ASF notes that impediments (if any) of the current European risk retention rules will be considered as part of the broader goal of facilitating a better functioning securitisation market in the EU.

3.15 The ASF also notes the current work of the IOSCO-BCBS joint working group (co-chaired by Greg Medcraft of ASIC and David Rule of the Bank of England). This working group includes the international insurance and accounting bodies (IAIS and IASB) and is also investigating impediments to the recovery of global securitisation markets. The ASF understands that a securitisation paper is being prepared by the IOSCO-BCBS working group for presentation to the G20 Finance Ministers meeting in Cairns in 20-21 September 2014.

3.16 The ASF does not support the proposed risk retention regime in the Discussion Paper. Our members seek a framework that strikes a balance between alignments with regimes in other jurisdictions but reflect the safeguards already inherent in the Australian market. Hence the ASF requests additional time to consult with industry and APRA on the optimal approach to the design and implementation of risk retention rules in Australia. As noted above, such an approach ideally would be harmonised (or mutually recognised between applicable regulators) with European and U.S. risk retention rules that will be applicable after the 2016 implementation of the new APS 120.

3.17 It is the ASF's view that any risk retention requirement should allow options to meet the requirement. The Discussion Paper indicates that APRA is proposing not to consider the "representative sample" option as a permitted means of satisfying a credit risk retention regime for ADIs. The ASF respectfully requests that APRA further consider this issue and submit that the representative sample option should be recognised as a permitted risk retention option. In particular it is not clear to the ASF that a representative sample option would involve *"added complexities associated with monitoring the randomisation process and any relevant disclosures"*. It is our view that it is not a materially complex process and its availability under the CRD IV risk retention rules has allowed a number of ADIs to both comply with CRD IV and achieve capital relief under the current APS 120.

3.18 Specifically, and without prejudice to the general comments above regarding the deficiencies of the currently proposed risk retention rules, the ASF suggests that APRA defer its design and formulation of optimum risk retention rules until the second phase of its consultation on APS120. This would allow the IOSCO-BCBS joint working group, the G20 and other forums to shed further light on the future global direction with respect to risk retention. The ASF believes that this is warranted and justifiable given:

- the ongoing work and reviews being conducted by global regulators (summarised above):
- the fact that there has been no evidence of misalignment of interests in the Australian securitisation market (as noted above);
- to the ASF's knowledge, no domestic investors are currently agitating for domestic risk retention rules; and

- APRA's own proposed timeframe with respect to the circulation of a second consultation paper on the revised APS 120 in the first half of 2015 and targeted implementation in January 2016.

3.19 Finally, as a technical matter, the ASF submits that it should be clear that any credit risk retention requirement should apply only to an originating ADI that directly or indirectly originates the underlying exposures in the pool, and should not extend to an originating ADI which is solely an originating ADI by virtue of it being a *"managing ADI"*. That is, for the purposes of credit risk retention, the definition of originating ADI should exclude the managing ADI.

Clarification of the meaning of "*pari-passu for credit purposes*"

3.20 The Discussion Paper states that APRA is proposing that a securitisation structure may possess multiple tranches of A class securities, provided that each sub-class of A class securities rank *"pari-passu for credit purposes"*.

3.21 The ASF would appreciate clarification as to what APRA means by the expression "*pari-passu for credit purposes*".

3.22 In particular, the ASF submits that such condition should be satisfied if each sub-class of A class securities rank equally for repayment of principal and interest following the occurrence of an event of default and enforcement of the relevant security over the SPV (that is, equal ranking in the post event of default cash flow waterfall).

3.23 The ASF submits that such an approach would be consistent with APRA's statements in the Discussion Paper[6] that a securitisation structure could contain several fixed tranches, within the A class, with differing maturities, with tranches with shorter maturities ranking before tranches with longer maturities for the purposes of repayment – which suggests that, prior to the occurrence of an event of default, sub-classes of A class securities may have different rankings for repayment of principal (that is, different rankings for the purposes of repayment, whilst still having an equal ranking for credit purposes post an event of default).

3.24 As a technical matter, in securitisation transactions involving both AUD denominated tranches and non-AUD denominated tranches of securities, it is typical that (in the post event of default waterfall) a portion of payments in respect of the non-AUD denominated tranches is subordinated to payments in respect of other classes of rated securities. Broadly, the possibility of such subordinated payments will only arise if the relevant currency swap has been terminated (and not replaced), and the quantum of such subordinated payments (if any) will typically depend on the then spot rate of exchange (compared to the rate of exchange which would have applied had the relevant currency swap remained in place). The purpose of this limited subordination is to ensure that other tranches of AUD denominated securities are not exposed to the currency exchange risk which is properly borne by the non-AUD denominated tranches. This feature is typically required both by investors and rating agencies. The ASF submits that this feature should not, of itself, result in a non-AUD denominated tranche of securities ceasing to satisfy the "*pari-passu for credit purposes*" test.

[6] Page 15 of the Discussion Paper.

3.25 The ASF would also appreciate clarification that nothing in the Discussion Paper is intended to prohibit a securitisation structure from allowing the repayment of principal between A class securities and B class securities on a pari-passu basis prior to the occurrence of an event of default. For example, to facilitate such pari-passu repayments based on the satisfaction of a typical step down test formulation.[7]

Designation of securitisations as funding-only or for capital relief at inception

3.26 The Discussion Paper states that an originating ADI will need to designate a securitisation as funding-only or for capital relief at the inception of the transaction.[8]

3.27 The ASF would appreciate clarification as to whether an originating ADI can subsequently change its designation of a securitisation as funding-only or for capital relief.[9] For example, if a securitisation is initially designated as a funding-only securitisation (with the originating ADI holding the entirety of the B class securities), can the originating ADI later redesignate that securitisation as a capital relief transaction in the event that the originating ADI sells down part of its holding of the B class securities?

3.28 Also, it would assist if further detail could be provided regarding whether a securitisation with multiple classes of B class securities (e.g. B1, B2, B3) could be designated as a capital relief transaction, where the originating ADI initially holds 100% of each sub-class of B class securities (and therefore claims no capital relief). For example, an originating ADI may wish to structure a transaction with multiple sub-classes of B class securities with the intention to offer those securities to the market. However, if for whatever reason there is insufficient investor demand during that marketing process, the originating ADI may wish to itself retain 100% of each sub-class of B class securities, rather than restructure and remarket the transaction with a single class of B securities (taking into account, amongst other matters, the cost and timing implications of any such restructure and remarketing).

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7 A typical step down test will allow for pari-passu repayments of senior and subordinated classes of Notes after the second year of the securitisation provided that (i) no losses have been charged-off against the Notes and have not otherwise been reimbursed; (ii) arrears are less than a prescribed minimum amount; (iii) the level of subordination has at least doubled from the level of subordination as at the closing date of the securitisation; and (iv) the call option date has not occurred.

8 Page 17 of the Discussion Paper

9 The ASF notes that possibility of such a conversion appears to be contemplated on page 18 of the Discussion Paper (in the context of the discussion on date-based calls)

Section 4 - Other Technical Issues

Trust Back

4.1 The current practice by ADIs engaged in securitisation activities in Australia is not to require customers to sign a second mortgage in respect of additional exposures retained by the ADI but secured by a mortgage that has been assigned by the ADI to a securitisation SPV. Instead, ADIs use certain contractual arrangements (described below) known as "trust-back" arrangements to achieve substantially the same result as a formal second mortgage.

4.2 The ASF submits that a requirement for an ADI to enter into actual second mortgages with customers in these circumstances:

- would place an undue administrative and cost burden on the ADI;
- would result in limited (if any) incremental benefit to the ADI (over the contractual rights already afforded to the ADI under a typical trust-back arrangement); and
- would likely limit the level of securitisation activity by the ADI.

4.3 The ASF notes that paragraphs 90 and 91 of APG 120 have provided ADIs with some guidance as to when ADIs are to be considered second mortgagees. However, because (as noted above) ADIs do not require a customer to sign a second mortgage in these circumstances, these words have caused confusion for securitisation market participants.

4.4 The ASF submits that the rights and protections afforded to the ADI under a typical trust-back arrangement are, in substance, equivalent to the rights and protections which the ADI would have as the holder of a formal second mortgage

4.5 The ASF submits that there are two key issues to be considered in connection with this topic:

- first, the ability of the ADI to enforce the mortgage the subject of a typical trust back arrangement for the benefit of the retained exposures (including credit cards, personal loans and home loans not equitably assigned to the SPV) the subject of the trust back; and
- second, the consequences for retained exposures of the making of a further advance on the securitised exposures secured by a mortgage the subject of a typical trust back arrangement.

Each of these issues are considered in the following paragraphs,

Mortgage Enforceability

4.6 The following describes a relatively typical trust-back arrangement (although there may be some minor differences under different securitisation programme documents):

4.6.1 a customer grants a mortgage ("shared mortgage") in favour of an ADI, which secures two loans ("securitised loan" and "retained loan");

4.6.2 in connection with the relevant securitisation:

two separate trusts are constituted:

A. the securitisation SPV trust (with the ADI typically being the primary beneficiary of that SPV trust, subject to the interests of the secured creditors); and

B. the trust-back trust (with the ADI being the sole beneficiary of that trust-back trust);

- the trustee of the securitisation SPV trust ("SPV Trustee") will be the same legal entity as the trustee of the trust-back trust ("Trust-Back Trustee") and will typically be a third party professional trustee company;
- the ADI assigns the securitised loan to the SPV Trustee; and
- the ADI also assigns the shared mortgage which will be held:

a) to the extent it secures the securitised loan, for the benefit of the SPV Trust; and

b) to the extent it secures the retained loan, for the benefit of the Trust-Back Trust (such interest therefore forms part of the assets of the trust-back trust "Trust-Back Assets").

4.6.3 under the express terms of the trust-back trust, the Trust-Back Trustee must act in accordance with any direction given to it by the ADI in respect of the Trust-Back Assets (i.e. the shared mortgage) (subject to limited exceptions, such as the Trust-Back Trustee not being obliged to act if it considers it would be illegal to do so); and

4.6.4 all proceeds received from enforcement of the shared mortgage must be applied in accordance with a prescribed order of priority. Typically that order is:

- first, in satisfaction of amounts payable under the securitised loan; and
- next, in satisfaction of amounts payable under the retained loan.

4.7 The ASF notes that APRA has indicated on page 30 of the Discussion Paper that:

"It is not always clear with trust-back arrangements that trustees with obligations to protect investors would necessarily seek to enforce the collateral to protect an ADI's personal loan exposures that are not part of the securitised pool of mortgages."

4.8 The ASF questions this assumption and respectfully asks APRA to further consider its assessment in this respect. In the ASF's view, a typical trust-back arrangement provides robust protection to the relevant ADI as regards enforcement of the shared mortgage. In particular:

4.8.1 the Trust-Back Trustee and the SPV Trustee are both bound by terms of the documents which establish the SPV Trust and Trust-Back Trust, which documents typically include terms regulating enforcement of the shared mortgage;

4.8.2 (as noted above) the Trust-Back Trustee is obliged to act in accordance with any direction given to it by the ADI (as the sole beneficiary of the trust-back trust) in respect of the Trust-Back Assets (for example, a direction to enforce the shared mortgage); and

4.8.3 the Trust-Back Trustee acts in a trustee capacity and accordingly is subject to certain fiduciary duties to the ADI (as the sole beneficiary of the trust-back trust).

4.9 In the ASF's view, there is no reason to believe that a Trust-Back Trustee (being a professional trustee company) would disregard its contractual and fiduciary duties to the relevant ADI (in particular, noting that by doing so it would thereby potentially expose itself to personal liability for breach of trust).

Further Advances

4.10 As noted above, proceeds received on enforcement of a shared mortgage are typically applied first towards payments of all amounts owing under the securitised loan, with the remaining balance then being applied towards payments of all amounts owing under the retained loan.

4.11 In this way, the typical trust-back arrangement replicates in substance the outcome that would be achieved if an actual second mortgage was put in place.

4.12 However, the ASF notes the requirements of a formal second mortgage as described in paragraph 13 of Attachment D of APS 112. In particular, the requirement that the first mortgage must not be extended without being subordinated to the second mortgage. Accordingly, the ASF assumes that APRA is concerned to ensure that a typical trust-back arrangement does not facilitate the further subordination of the retained loan, as a result of the making of further advances in respect of the securitised loan, in a manner inconsistent with paragraph 13 of Attachment D of APS 112. If this assumption is correct, the ASF is of the view that the issue is properly addressed by the prohibition (typically included in most ADI securitisations (including as a result of rating agency requirements)) on the making of any such further advances. Typically, the ADI is prohibited from making a further advance in respect of the securitised loan (after the date of sale to the securitisation SPV) and instead will repurchase that loan (and potentially any other loans sharing the same shared mortgage), as permitted by paragraph 5 of Attachment F of APS 120, to facilitate the making of that further advance.

4.13 The ASF submits that the wording of paragraph 27 of Attachment B of APS 120 could readily be amended to refer to either a formal second mortgage arrangement being in place or the securitisation being structured so as to afford, in substance, protections equivalent to a formal second mortgage.

Funding Only Securitisations

4.14 The ASF understands that it is APRA's intention that in assessing whether claims are secured by relevant collateral under APS 112 and APS 113, APRA proposes that an originating ADI may treat the securitisation pool as if the exposure in the securitisation pool were held by the ADI and that this is to ensure that higher risk-weights do not apply for exposures the subject of funding-only securitisations. It would be useful if this is explicitly recognised in the revised APS 120.

Requirement for a Second Mortgage

4.15 The ASF believes that APS 120 should state that in the event that an ADI is able to demonstrate that it has in place an arrangement most likely in the form of a trust back structure described above that ensures it is in the same position with regards the exposures that have not been transferred to the securitisation pool but are which secured on collateral assigned to an SPV then it should be able to continue to apply the same risk weight to these exposures post the securitisation without requiring a formal second mortgage. The ASF understands that APRA has concerns that the legal advice in this regard has not always been clear. However, the analysis above is supported by the King & Wood Mallesons and Clayton Utz who advise the vast majority of ADI securitisation issuers. The ASF would be open to APRA requiring that issuers obtain a legal opinion that the trust back arrangements put in place for a securitisation are sufficient to ensure the ADIs position with regards enforcing on the loans outside the securitisation pool remains the same.

Other issues – unequivocal enforcement rights

4.16 In discussing the current APS 120, APRA notes on page 30 of the Discussion Paper:

> *"In a securitisation, collateral is potentially transferred to the trustee of the SPV as trustee for the beneficiaries, i.e. the investors. If an ADI cannot demonstrate that it has unequivocal enforcement rights, it cannot 'look through' the SPV and apply a risk weight of less than 100 per cent."*

4.17 The ASF would appreciate clarification as to what is meant by reference to the ADI retaining "unequivocal enforcement rights".

4.18 In particular, a securitisation typically involves an equitable assignment by ADI of all of its right, title and interest in the relevant loans to the securitisation SPV. That is, whilst the ADI remains the legal owner of the loans, the assignment of the loans to the securitisation SPV is recognised as a matter of equity.

4.19 It is not clear to the ASF what rights the ADI needs to retain to satisfy the "unequivocal enforcement rights" test. The ASF notes that securitisation transactions are typically structured so that the ADI is appointed as the servicer and the securitisation SPV contracts the servicer to conduct all enforcement action on behalf of the SPV.

4.20 The ASF would appreciate clarification from APRA that a typical securitisation (that is, involving an equitable assignment by the ADI with the ADI remaining as servicer of the loans) is consistent with the requirement that the ADI retains unequivocal enforcement rights.

Date Based Calls

4.21 As noted in the Discussion Paper, date-based calls provide a number of benefits to securitisation structures that improve their marketability to investors and reduce costs to issuers.

4.22 The ASF welcomes APRA's proposal to allow date-based calls for funding only securitisations. However, the proviso in the Discussion Paper that a date-based call can be set no earlier than

the projected 10% clean-up point eliminates much of the potential value that date-based calls would provide.

4.23 It would not be possible to create multiple tranches within the A class with different maturity profiles and then use date-based calls to give investors greater comfort that their tranche will be redeemed on an expected date, other than the expected 10% clean-up point. A date-based clean-up call has no value in a master trust structure, where multiple series of class A notes are issued at different times, with different maturities against a single pool of revolving collateral. The call needs to be linked to a specific series of notes, rather than the pool of securitised assets, because the pool would almost certainly only amortise to a 10% clean-up point when the issuance program is in permanent wind down.

4.24 The ASF notes the view that allowing date-based calls outside the 10% clean-up may facilitate an early exit for investors, protecting them from absorbing credit losses had they otherwise remained in the securitisation. However, in a funding only securitisation, the originating ADI will still be holding the full amount of capital against the securitised assets as if they had not been securitised.

4.25 If in the funding only transactions, the originating ADI holds the class B subordinated note only and is able to sell all of the senior notes to third party investors, it is important to note that whilst the originating ADI will continue to hold capital on the entire amount of collateral, the losses that it will cover will be restricted to size of the subordinated notes that it holds.

4.26 Losses over and above the subordinated notes will continue to be passed onto the senior note holders and other secured creditors as set out in securitisation cash flow waterfalls. Soft bullets in RMBS and ABS structure do not represent credit protection from tail-end credit risks. Soft bullets only provide increased repayment certainty and a reduction in prepayment and extension risks. Therefore, in the ASF's view, APRA's concern in this regard is not valid.

4.27 In addition, the ADI will also include date-based calls in its liquidity models assuming that the call is exercised at the first possible opportunity and so will also have appropriate liquidity to cover the potential cash outflow. The call option would be totally voluntary on the part of the issuer. If the call is not exercised the investors would have no recourse to the issuer but the margin on the notes would likely increase by a pre-determined amount (reflecting such things as the increase cost for the investors for the extended tenor where such increases in costs will be met by income from the underlying assets). The ASF notes that whilst the Basel Committee does not allow for date-based calls in regulatory capital relief securitisations, it does not place any restrictions on date-based calls in securitisations where capital relief is not being sought. APRA allows date based calls on other funding and capital instruments issued by ADIs such as Tier 2, senior unsecured and covered bonds. Such instruments provide investors with direct recourse to the ADI, unlike RMBS and ABS.

4.28 The ASF recognises that APRA may have a concern that allowing dated-based calls could introduce new systemic risk by virtue of the fact that a failure by an ADI to meet a date-based call is seen by the market as a lead indicator the ADI's stress. The ASF believes that this concern is misplaced for three reasons: (a) this very risk already exists as a result of the presence of 10% clean-up calls (which cover entire standalone transactions rather than

individual tranches), (b) securitisation represents a very modest proportion of overall funding so systemic risks are limited, and (c) the fact remains that, in securitisations, these are optional calls and present ADIs with an additional tool in managing their outflows in times of stress; this tool is not available for other funding arrangements such a senior unsecured or covered bond issuance.

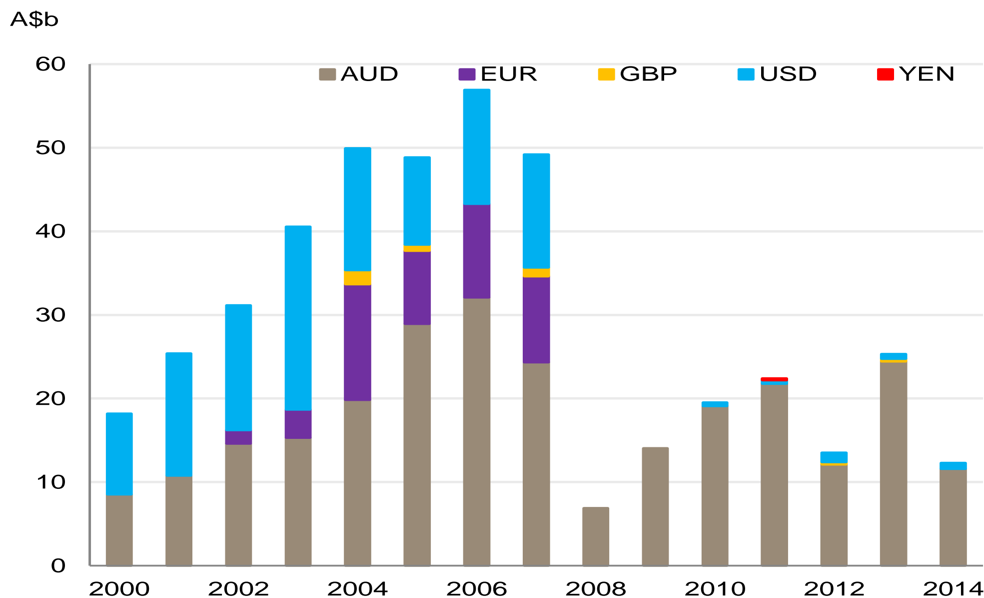
4.29 As a separate point, and without prejudice to the arguments above, the ASF further proposes that where an originating ADI holds all the securities in a funding only securitisation (other than where they have been acquired from investors), for example in a self-securitisation or where the Class A securities have fully amortised prior to the 10% clean up call, the originating ADI could call the securities and collapse the securitisation. In these situations, the originating ADI holds all the credit risk and would hold the relevant amount of capital for those assets. Where there are no external investors there should be flexibility to unwind a funding only securitisation.

4.30 There are some technical points relating to how the date based call would operate for which the ASF would be grateful for clarification:

- how does APRA propose that the projected 10% clean-up point is determined? Will APRA allow the originating ADI to assume a level of prepayment on the underlying pool of assets? The ASF would suggest that originating ADIs are able to use the same assumed prepayment rate as which forms the base case when the securitisation is being marketed to investors.
- The third condition for date-based call options in funding only transactions is unclear. The ASF would suggest that any notes subject to the date-based call option be able to be called at an amount no greater than the invested amount of the notes less any losses that have been allocated to that class of notes. This should provide APRA comfort that the date-based call option is not providing credit enhancement.
- For a 10% clean up call in an open pool securitisation where the pool may rise and fall over time, what should the 10% be applied to in order to determine the pool size at which the clean up call could be exercised? For example:
  - 10% of the largest pool historically;
  - 10% of any limit of the securitisation;
  - 10% of the balance at the date the last assets were added to the pool; or
  - 10% of the initial issuance total.

Funding-Only Securitisations and "All Reasonable Steps" for ADI Liquidity

4.31 The ASF notes that APRA considers that its proposed reforms to the funding-only securitisation regime will allow larger ADIs to increase their term wholesale funding via securitisation.



4.32 As shown by the chart above, the domestic RMBS market has nearly recovered to issuance levels seen pre-GFC. Offshore investors are also starting to re-emerge; however, the proportion of investors from offshore remains relatively small.

- Total AUD denominated RMBS issuance of ~A$25b in CY13 was comparable to AUD-denominated issuance volumes in CY 2007.
- CY 2007 total RMBS issuance was A$50bn which was double the RMBS issued CY 2013. Peak RMBS issuance was close to A$60bn in 2006
- Foreign currency RMBS issuance in 2007 was A$25bn (mostly sourced from USD and Euros) compared to foreign currency RMBS issuance in 2013 which was less than A$1bn
- The current stock of Australian RMBS outstanding is $104bn compared to A$220bn in 2007.
- The share of housing credit funded by RMBS has fallen from the peak of ~23% in mid-2007 to less than 10% now.

4.33 If APRA is expecting ADIs to be able to meaningfully increase their term securitisation issuance then the ability to tap offshore investors will be a key factor. There are a number of factors that are limiting investment from offshore in Australian RMBS that has been well flagged by the ASF and other industry participants, including:

- The absence of date based calls and master trusts in Australia;
- The cost of cross currency adding significantly to the landed cost, restricting issuing of foreign currency denominated tranches;

4.34 Whilst the Discussion Paper does contemplate ADIs being able to use date based calls and issue from master trusts the provisos that APRA has added to date based calls and master trusts in particular will mean that it is unlikely that either could be implemented by an ADI and then be able to access offshore investors in a meaningful way.

4.35 In addition, the inability to use master trusts means also that ADIs are unlikely to be able to securitise new asset classes such as credit cards which could also be used to increase term securitisation issuance.

4.36 Therefore, the ASF is of the view that it is unlikely that there will be a material increase in securitisation issuance by ADIs if the new securitisation standard is implemented in accordance with the Discussion Paper.

Self-Securitisation

4.37 APRA's proposal to capture self-securitisations within the definition of funding only securitisations is likely to create unnecessary changes to transaction structures, where the only reason for executing such transactions is to have access to the Committed Liquidity Facility from the RBA. Self-securitisations are held by treasury departments of ADIs and there is no active secondary market for the securities. The only external party apart from the sponsor ADI that could hold the repo eligible securities issued by self-securitisation trusts will be the RBA. Elements of capital relief risk transfer concepts and concerns are still embedded in APRA's proposed rules on funding only transactions (e.g., the strict provisos relating to date-based calls discussed above). If the capital relief related concerns are not stripped out of funding only structures, the proposed funding only rules are likely to result in encumbrance of more assets to support self-securitisations, an outcome that will likely reduce the amount of assets available to ADIs depositors.

4.38 The Discussion Paper proposes that self-securitisations must be structured in the same way as funding-only securitisations. The ASF does not fundamentally object to this proposal. However we do not believe that they need to be structured with only one B class. The ASF believes that by allowing ADIs to have flexibility to structure self-securitisations with more than one B class will allow ADIs: a) to keep existing self-securitisations structures in place that have been structured with more than one B class; and b) retain the ability to sell the junior notes from self-securitisations at a future point in time.

4.39 APRA proposal that "self-securitisations must be structured in the same way as funding-only securitisations so as to facilitate a seamless transition, ultimately, to a structure where there is an external beneficial interest." would require ADI to restructure the existing self-securitisation programs at significant expense. ASF recommends that ADIs that have existing self-securitisation programs in place are may nominate the structures as "funding only" without the expense and operational burden to restructure the deals.

Transition Arrangements

4.40 ASF requests that APRA clarify the transition arrangements, especially with respect to capital relief. For "existing term securitisations, where an ADI has met the operational requirements for regulatory capital relief under the current APS 120, the ADI will be able to transition the structure to the 10 per cent clean-up call;"[10] Does this paragraph allow ADIs which have satisfied the operational requirements for regulatory capital relief prior to the introduction of the new APS120 standard to continue to achieve capital relief for the existing securitisations?

Unfunded Support

4.41 The ASF welcomes APRA's proposal to review APG120 so that 'support' in the context of unfunded support will be interpreted from a substantive perspective. The Discussion Paper indicates that certain swaps and liquidity facilities would not be considered 'support' for the purposes of this requirement. For a liquidity facility, the Discussion Paper indicates that it will be important to consider the amount involved and the length of time any mismatch is likely to last. In addition the Discussion Paper indicates that where the facility is materially relied upon for the purposes of the rating, APRA proposes to consider the facility to be 'support' for these purposes.

4.42 The ASF understands APRA's concern that where a rating is driving the risk weighting and capital held by an ADI for a securitisation exposure and that rating is supported by a facility or swap from the ADI then the risk weight and capital held may not be appropriate for the level of risk inherent in the underlying assets and structure. This is consistent with APRA's principle that credit risks in securitisation must be clearly assigned and properly capitalised.

4.43 The ASF notes that the Consultative Document – Revisions to the securitisation framework issued 19 Dec 2013 by the Basel Committee on Banking Supervision (BCBS) states that one of the requirements of the Ratings Based Approach is that the rating is not based on a guarantee or similar support provided by the bank itself.

4.44 The ASF proposes that swaps and liquidity facilities are not similar support to a guarantee which provides credit enhancement for investors which removes the direct look through to the underlying assets for the credit risk assessment. Swaps and liquidity facilities typically don't have these features as they are focused on managing cash flow mismatches rather than protecting against credit risk.

4.45 In addition the BCBS has previously used the example of a liquidity facility to an ABCP conduit which supports that rating of the ABCP. In this case the liquidity facility supports the repayment of ABCP at the legal maturity of the ABCP. The facility covers the mismatch between expected receipt of principal on the underlying assets and the legal maturity of the securities.

4.46 This is an important difference to most liquidity facilities currently used in securitisation in Australia which support interest and expense payments in the event of a difference between the timing of expected receipt of income and actual receipt of income from the underlying

[10] Page 33 of Discussion Paper

assets or mismatches between when principal is expected from the underlying assets and when it is actually received.

4.47 The ASF would like to clarify what are the considerations for swaps as to whether they will be considered “support”? The common types of swaps used in Australian securitisations are:

- Fixed/floating interest rate swaps;
- Basis swaps; or
- Cross currency swaps.

These swaps can have notional amounts up to 100% of the face value of the notes or amount of the pool of assets

4.48 The ASF would not consider these swaps as support as they:

- don’t provide credit enhancement. Their purpose is to manage cash flow mismatches only;
- are typically ranked senior to or pari-passu to Class A notes; and
- typically contain downgrade language. Such that following a downgrade of the rating of a swap provider, the exposure of investors in the securitisation to the swap provider is reduced. This may be through either the posting of collateral including a buffer above the market value of the swap, replacement of the swap provider or procuring a guarantor of the swap provider’s obligations.

4.49 For liquidity facilities, what guidance will be provided in relation to the amount involved and length of time any mismatch is likely to last? How will it be determined that a facility is materially relied upon for the purposes of the rating? Typically without the swap or liquidity facility the rating would not be assigned by the rating agency. The approach of the rating agency is binary in outcome even for swaps or facilities that are a small percentage of the overall transaction.

4.50 The ASF proposes that:

- Swaps in a securitisation that adjust the basis (fixed/floating or floating/floating) or currency of the underlying cash flows are not considered as ‘support’ as they are not designed to provide credit enhancement and have requirements for the swap provider to mitigate the securitisation’s exposure to it.
- Liquidity facilities that only cover interest and expenses of a securitisation due to timing mismatches between actual income received and expected income not be considered as support.
- Cover principal of securities not be considered as support where the facility is designed to cover timing mismatches between the actual and expected collection of principal from the underlying assets and is not used to make good losses on the underlying assets. This type of facility is distinguished from ABCP style facilities which cover mismatches between the collection of principal on the underlying assets and the repayment of ABCP at the legal final maturity date.

- Contain downgrade language to mitigate the exposure of investors in the securitisation to the liquidity facility provider through the provision of collateral, replacement or guarantee of the liquidity facility provider not be considered as support.

Resecuritisation

4.51 The ASF believes that the definition of resecuritisation should explicitly state that use of multiple legal entities does not in and of itself create a resecuritisation. The ASF notes that the Basel Committee has taken this approach and has also noted that a resecuritisation is where there is an increase in correlation risk. The ASF requests confirmation that the resecuritisation definition outlined in the BCBS paper is adopted in the revised APS120.

4.52 In relation to ABCP, the ASF does not believe that all claims in an ABCP conduit structure should be treated as resecuritisations. For example, the provision of liquidity facilities to stand alone, originator specific SPVs that are then funded by an ABCP vehicle should be treated as securitisation exposures not resecuritisation exposures. This is because if such a facility is drawn, the repayment of the facility will be dependent solely on the performance of the assets within the SPV it is funding and not other securitisation exposures that may be funded by the ABCP vehicle. The ASF notes that the Basel Committee specifically allows for banks to risk weight exposures to ABCP programmes based on an internal assessment approach that considers such exposures to be securitisation exposures.

4.53 The ASF also notes that whilst the Basel Committee does apply higher risk weights to resecuritisations in recognition of a higher credit risk profile, it does not require all exposures to be a deduction from CET1. The ASF considers APRA's approach as overly conservative and recommends APRA to reconsider the regulatory capital for resecuritisations to be aligned with that proposed in the BCBS securitisation framework.

Regulatory capital for senior/non-senior tranches

4.54 The ASF notes that the regulatory capital treatment of senior and non-senior securitisation tranches is subject to review by BCBS following its consultation on risk weights for securitisation. We suggest any decision on the regulatory capital treatment of non-senior tranches should be deferred until the BCBS policy is finalised.

4.55 The Discussion Paper proposes the regulatory capital treatment for all non-senior tranches of any securitisation will be subject to a CET1 deduction. This means that a non-senior tranche that is rated AA, for example, will attract a capital deduction. The ASF believes that this does not reflect the credit risk of the tranche and requests clarification from APRA on the rationale of the proposed capital treatment for all non-senior tranches.

4.56 The ASF requests clarification whether APRA is proposing that any non-senior securities held by an originating ADI will attract a CET1 deduction[11], in addition to the regulatory capital requirements under the funding only or capital relief securitisation.

4.57 In relation to a securitisation where there are multiple tranches, an ADI may hold the senior tranche as well as concurrent tranche(s) to that senior tranche. The ASF seeks confirmation

[11] Discussion Paper, page 23 "any ADI investing in anything other than the senior classes of any securitisation issued by any type of issuer will attract a CET1 deduction"

from APRA that the securitisation exposure for the ADI would be considered senior and the risk weight would be equivalent to the lowest attachment point of the tranches held.

Synthetic securitisation

4.58 ASF believes synthetic securitisation is an important tool for portfolio risk management purposes, particularly to manage wholesale exposures on an ADI's balance sheet.

4.59 Given wholesale exposures may have certain restrictions placed upon them such as the physical assignment of corporate loans and dealing with confidential client information, it would be very challenging to use traditional securitisation. Where no other loan hedging alternatives are available, preventing synthetic risk transfer may hinder an ADI in efficiently managing its concentration risk and diversifying its portfolio. The ability to employ synthetic securitisation can release regulatory capital for an ADI, and enhance its ability to lend to the real economy. ASF believes in order for ADIs to remain competitive with international counterparts (as permitted by BCBS) synthetic securitisation should be available to Australian ADIs.

4.60 ASF would welcome the opportunity to consult with APRA ahead of the next securitisation consultation paper on synthetic securitisations. ASF believes this consultation would (a) provide APRA with a more detailed understanding on how synthetic securitisation would contribute to the real economy; and (b) enable APRA to consider clear guidelines for synthetic securitisation to ensure alignment with APRA's key principles of simplicity and transparency.

Section 5 - Cost-Benefit Analysis Information

The Discussion Paper sought information relating to the compliance impact of the proposed changes outlined in the Discussion Paper. In terms of cost implications, there are a number of issues to consider and the ASF plans to submit a more granular breakdown in due course as agreed at our meeting on 6 August 2014.

Master Trusts

Our initial comment on costs relating to the introduction of master structures is predicated on the structure proposed by the ASF, not the master trust structure proposed by APRA in the Discussion Paper.

At this stage, we see limited, if any, additional compliance cost being introduced through the proposals as they stand. Rather, investor reporting for master trusts once established will be less onerous than generating reports for individual standalone transactions and we anticipate a reduction in man hours as a result.

In addition, the general maintenance of a programme, including payments, management of third party providers, the establishment and management of SPVs, will be less onerous and more cost efficient. We view this as an additional, albeit ancillary benefit, to master trust arrangements.

We have also compared legal costs of running master trust programmes against standalone trusts. Whilst there is substantial initial cost involved in establishing a programme, with fee quotes ranging from A$250,000 to A$350,000 with an additional cost of approximately A$150,000 for incorporating a US 144a issuance capability. Ongoing legal expenses will be significantly reduced, with each issuance estimated to involve approximately A$30,000 of additional cost as opposed to each standalone issuance of A$70-100,000. This is also less time consuming for legal teams to manage.

Having the ability to use date based calls and master trusts will enable ADIs to complete larger deals, so with some deal costs being fixed costs as a percentage of deal sizes will fall.

The establishment of master trust programmes will inevitably involve some technology upgrades. The cost of this is difficult to quantify since it will vary enormously between ADIs. We would expect each ADI to include some detail on this piece in their individual submissions.

Finally, there are intangible cost benefits associated with programmatic issuance structures. As consistently argued through the submission, we envisage significantly more secured issuance in the event that the key features that the industry is seeking are accommodated by APRA. This will result in another source of diversified term funding, less emphasis and reliance on both the local RMBS investor base and the senior unsecured and covered bond markets and a stronger and more resilient banking system as a consequence.