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Dear Pat

Submission to APRA Discussion Paper – Revisions to the prudential framework for securitisation

The Australian Securitisation Forum (**ASF**) appreciates the opportunity to respond to the *Discussion Paper "Revisions to the prudential framework for securitisation"* (**Discussion Paper**) and the draft APS 120 released for comment in November 2015 (**proposed APS 120**). The ASF appreciates the dialogue it has had with APRA to date and believes much of the revised approach set out in the proposed APS 120 and the Discussion Paper provides a sound platform for the future use of securitisation by ADIs for funding, capital relief and investment.

We outline what we see as the main issues arising from the Discussion Paper and the proposed APS 120 and provide suggestions in relation to these issues in the "Main Points" section of this letter. We then expand on these issues in the "Detailed Discussion" section of this letter. The "Detailed Discussion" section also sets out other issues and our suggestions.

The ASF notes that APRA intends to give further consideration to possible encumbrance limits as mentioned in section 4.3 of the Discussion Paper. The ASF welcomes the opportunity to provide comment on any proposed limits following the release of APRA's proposal in that regard.

The ASF would also like to leave open the possibility of making a submission to APRA on the earlier implementation of certain aspects of the APS 120 reform as noted in the Discussion Paper.

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

Yours sincerely

Chris Dalton

MAIN POINTS

1. **The overall health of the Australian securitisation market is, in the near term, sensitive to the impact that changes to APS 120 could have on major bank capital requirements.** The combined effect of the RBA's Committed Liquidity Facility (**CLF**) and the withdrawal of foreign banks following the global financial crisis (**GFC**) has resulted in the Australian securitisation market becoming highly dependent upon the major banks in funding smaller ADI and non-bank lenders, particularly term RMBS and "warehousing"[1] en route to term RMBS/ABS. This is most evident in the supply-demand dynamics in the domestic RMBS market in recent years.

2. **Accordingly the ASF submission is focussed on issues affecting the availability of securitisation funding** for both funding of "warehouses"[1] and investment by third parties and internal RMBS/ABS. In the near term there is unlikely to be an alternative, cost effective class of investors to replace major banks should their appetite to invest in securitisation issuance be curtailed due to increased capital costs.

3. **The ASF requests that APRA reconsider its proposed modification of the Basel Committee on Banking Supervision (BCBS) "Revisions to the securitisation framework" dated 11 December 2014 (Basel III Framework).** Instead, the ASF proposes the use of the Internal Ratings-Based Approach, with some conservative adjustments, as the primary rating approach given that this is the most risk sensitive and flexible approach to assessing securitisation exposures. Internal Assessment Approach is also fully supported to be permitted (as a subset of the External Ratings-Based Approach), in line with APRA's recognition for the Australian jurisdiction under the Basel II framework.

4. **The ASF supports the full alignment of the implementation date for risk weights attaching to Australian simple, transparent and comparable (STC) compliant transactions** with BCBS so as not to place Australian issuers and investors at a material disadvantage. To the extent BCBS aligns the implementation dates for STC and the Basel III Framework (i.e. 1 January 2018), the ASF's strong preference would also be for such alignment.

5. **The ASF requests that APRA reconsider its proposal which prohibits an ADI achieving capital relief for balance sheet synthetic securitisations.** The ASF fully supports the response submission made by the International Association of Credit Portfolio Managers to APRA in relation to the Discussion Paper.

6. **Australian securitisation markets will take time to adjust to the revised APS 120.** In the longer term, the ASF desires, as is APRA's intention, that changes to APS 120 result in Australian securitisation appealing to a broader group of investors and providing a safe, liquid and resilient source of funding to support competition in Australian lending markets. However this may take time. To better achieve these objectives, additional measures to enhance both the international harmonisation of securitisation regulations (such as mutual

[1] The ASF endorses the removal of references to the term "warehousing" in APS 120. The term is used here in the general sense of accumulating assets prior to refinancing in term securitisation markets.

recognition) and the liquidity of certain securitisation issuances (such as their recognition as high quality liquid assets (**HQLA**)) are desirable.

7. **The ASF welcomes the introduction of the revolving securitisation provisions.** A number of technical clarifications are sought to ensure that the market practices that are likely to evolve pursuant to these provisions meet APRA's expectations. The ASF proposes to separately submit a detailed master trust term sheet to illustrate the cashflow waterfalls and variability of the seller share for residential mortgages and credit cards.

8. **The removal of the 20% securities holding limit would make funding-only securitisation more effective.** The Discussion Paper appears to reference the removal of the 20% holding limit only in the context of trading senior securities. It is important for funding-only transactions that the originating ADI has the ability to retain >20% of the securities outstanding. Such restrictions are not evident in international securitisation markets and this makes issuance by ADIs relatively less competitive in international markets.

9. **The ASF requests APRA to reconsider the equivalency of the trust back arrangements to a formal second mortgage arrangement.** The requirement for an ADI to obtain a formal second mortgage in respect of loans (one of which is securitised) where there is a shared mortgage instead of utilising a trust back arrangement has a significant impact for the ADI (including cost and operational). The ASF seeks to illustrate the equivalency (at the very least) of the two differing arrangements (including following a perfection of title event) by undertaking a detailed legal comparative analysis in this regard.

DETAILED DISCUSSION

This section contains the ASF's detailed comments on the Discussion Paper and the proposed APS 120. It comprises of the following subject areas:

1. Section 1: Regulatory capital for securitisation exposures
2. Section 2: Revolving securitisations
3. Section 3: Capital relief transactions
4. Section 4: Trust back arrangements
5. Section 5: Miscellaneous other items including, among others, commentary on the liquidity treatment for minimum liquidity holdings, derivative transactions, self-securitisations and asset-backed commercial paper (**ABCP**).

1. Regulatory capital for securitisation exposures

The ASF supports the implementation of the Basel III Framework and the Basel initiative to implement criteria for STC securitisations. We believe this component of the global regulatory reform for securitisation, if implemented in a manner aligned to the Basel III Framework, will assist APRA in meeting its objectives of financial safety and efficiency, competition, contestability and competitive neutrality.

The ASF has noted that many features of APRA's revised consultation package will assist in strengthening the resilience of the Australian securitisation market. The ASF however notes that an appropriate and balanced implementation of the Basel III Framework is critical to ensure a functioning Australian securitisation market. The ASF appreciates the regulatory debate regarding the securitisation market has evolved since the GFC but encouragingly global regulators have come to the conclusion that securitisation can increase the balance sheet resilience of ADIs, improve competition and assist to fund the real economy.

With the implementation of the Basel III liquidity reforms and provision of the CLF by the Reserve Bank of Australia, Australia's largest banks have become important investors in Australian securitisation transactions. This demand for 'AAA' rated senior ranking RMBS and ABS by Australian banks has provided a great deal of support to the securitisation market since the AOFM's withdrawal in April 2013[2]. The major banks play important roles in the intermediation of finance between smaller ADIs and non-bank financial institutions (**NBFIs**) and the financial markets. These roles are important for competition and efficiency in the retail and SME banking markets. The Federal Government sought to support these markets through the AOFM's purchase of RMBS during the GFC. In addition, with the continued retreat of offshore banks from the Australian securitisation market, including Société Générale, RBS and Barclays, warehouse funding to regional banks, credit unions, building societies and non-ADIs is now predominantly provided by the major banks. The withdrawal of offshore banks has had little to do with concerns about the Australian securitisation market or the quality of the collateral supporting deals.

With this backdrop and context, it is important to understand that APRA's proposed modification of the Basel III Framework will have a significantly more concentrated impact on the Australian banking sector than would have been the case a number of years ago.

[2] http://aofm.gov.au/files/2013/07/Treasurer-Directions-for-RMBS-2013_9_april.pdf

The ASF is concerned about APRA's proposed modification of the Basel III Framework. This aspect of APRA's proposals does not strike the balance between safety and competition and will place Australian ADIs at a distinct competitive disadvantage to US and European banks. We believe APRA's divergence from the Basel III Framework will impose significant capital increases for Australian ADIs who provide securitisation funding to other ADIs or invest in term securitisations, over and above capital increases resulting from harmonised implementation of the Basel III Framework, which will materially and detrimentally impact both the availability and the cost of securitisation funding for smaller Australian ADIs including regional banks and the mutual sector. The proposed alignment of Advanced ADIs and Standardised ADIs in a securitisation context detracts from competitive neutrality as Australian Standardised ADIs provide no meaningful securitisation funding to other Standardised ADIs. The ability for Advanced ADIs to adopt an advanced assessment of securitisation exposures provides these ADIs with the ability to provide cost effective securitisation funding to other Australian ADIs and NBFIs, therefore promoting competition in a number of asset classes.

A key shortcoming of the Basel II framework identified by numerous global banking regulators, including APRA, was the mechanistic reliance on external credit assessment institutions (i.e. rating agencies). The global regulatory response to this has ranged from eliminating the use of external ratings in the US framework and subordinating the reliance on ratings in the updated Basel III Framework. A number of Australian ADIs have utilised other risk measurement tools with the clear aim of minimising the reliance of external ratings in their securitisation assessments.

The onerous capital charges imposed by the Standardised Approach (**SA**) in APRA's proposed framework will result in the increased use of, and therefore reliance on, external credit ratings which is not aligned with the global regulatory response to the shortcomings identified in the Basel II framework.

The ASF strongly supports the use of the Internal Ratings-Based Approach (**IRBA**) in the Basel III Framework. This is the most risk sensitive approach to assessing securitisation exposures and provides Advanced ADIs with the necessary flexibility to accurately assess the risks inherent in a securitisation when assigning regulatory capital. APRA appears to justify the removal of the IRBA on the basis that the current Supervisory Formula Approach (**SFA**) is sparingly used in Australia. In discussions with industry participants, we understand the primary reason for the SFA not being used more frequently in Australia is that APRA provides Advanced ADIs with the ability to use the Internal Assessment Approach (**IAA**) for assessing unrated securitisation exposures for the most frequently securitised assets in Australia (including residential mortgages, auto/equipment receivables and trade receivables – these assets comprise more than 95% of all securitised receivables).

The removal of IRBA from APRA's proposed APS 120, combined with the further step of removing the use of IAA, will have a significant impact on the industry, particularly for warehouse funding facilities which are predominantly assessed using the IAA. These warehouse facilities will either need to be externally rated or restructured with additional credit enhancement levels to minimise the proposed capital increases for these facilities. This will lead to inefficient funding structures for smaller ADIs and NBFIs, and substantially increase the cost of securitisation funding for these institutions. These proposed changes will do very little to support the growth of the industry or help meet APRA's prudential safety objectives.

1.1 Proposed APS 120 regulatory capital hierarchy

The ASF requests that APRA reconsider the proposed hierarchy of approaches to regulatory capital in the proposed APS 120. The sections below outline the ASF's views on the hierarchies and provide examples which demonstrate the unintended and punitive outcomes which result from APRA's proposed modification of the Basel III Framework.

1.1.1 External Ratings Based Approach (ERBA)

The ASF generally supports the inclusion of ERBA in the hierarchy of approaches in the revised framework for assessing securitisation exposures. However, we do not agree with its proposed position as the primary approach under the proposed APS 120 as this is fundamentally contrary to the primary objectives of the Basel III Framework[3], including removal of the "mechanistic reliance on external ratings". APRA's proposal to (i) remove the ability to use IRBA in the revised hierarchy and (ii) discontinue the use of IAA, will greatly increase the reliance on rating agencies from that under the current APS 120. This will lead to unintended consequences which the BCBS and other regulators have already noted in great detail in numerous publications including the Basel III Framework.

Regulators have highlighted that rating agency assessment in securitisation effectively results in 'stress testing' underlying exposures being securitised by applying assumptions determined solely by the rating agencies. Further, these assumptions may vary between jurisdictions a rating agency assesses, as well as between rating agency institutions. Rating assessments do not necessarily perform expected and unexpected loss analysis in a manner consistent with either ADIs or regulators. As such, the securitisation rating assessment can and has often (particularly offshore) resulted in divergent assessment of risk inherent in the securitisation exposure. Given the strong correlation between the performance of the underlying receivables and the securitisation exposure, the ASF does not support the primary rating approach for credit risk which places an over-reliance on a rating assessment and ignores the prudential and ADI assessment of expected and unexpected loss in a portfolio. To reduce the impact of the increased regulatory capital from the implementation of the proposed APS 120, a number of ADIs and NBFIs will need to investigate having bilateral warehouse funding facilities externally rated (which are currently unrated). This would avoid warehouse providers needing to assess these unrated exposures under the SA.

Not all securitisation exposures can be externally rated. Some limitations include:

- *Cost of rating securitisation exposures is significant for the issuer (sponsor)*. The rating costs comprise of an upfront fee to assign a rating and an on-going fee in order to maintain the rating throughout the life of the transaction. As an indication of the costs relating to rating each securitisation transaction:

Upfront fee	$80,000 to $100,000 minimum (ex GST)
On-going fee	$20,000 to $37,500 minimum (ex GST)

  This means the additional cost to an issuer for a 5 year transaction is significant, at more than $200,000.

[3] Basel III Framework, page 1

- *Disclosure of information to the capital markets*. Certain sponsors, particularly corporates who securitise their trade receivables, choose securitisation as a means to diversify funding. In many cases disclosure of information on the transactions leads to commercial disadvantages for originators.

- *Warehouse arrangements*. These often involve frequent settlements of new loans into warehouses, which the major banks are set up to handle operationally. Unlike the major banks, the rating agencies are not resourced for frequent (weekly) reviews of settlements. Instead they prescribe credit enhancement levels that take the worst case scenario from a credit perspective. This prescriptive approach results in untenably high levels of credit enhancement and therefore a structure that is not capable of efficient funding to the underlying originators and borrowers.

- *Potential deterioration in terms and conditions*. In bilateral unrated facilities, terms and conditions are often more onerous than those imposed by rating agencies and having these facilities rated could result in a deterioration in the credit quality of the securitisation exposure.

- *Impact of changes to rating agency methodology*. Having to rely on external ratings to determine regulatory capital requirements for securitisation exposures means that Australian ADIs will be subjected to fluctuations in capital for reasons other than the performance of the securitised assets, for example where ratings agencies decide to amend their rating methodologies resulting in downgrades of securitisation tranches that are not reflective of the performance of the underlying asset pool.

The ASF also does not agree with APRA's proposal to simplify the ERBA look-up table to eliminate its use for sub-investment grade tranches. The BCBS clearly highlighted that shortcomings in the Basel II framework included excessively high risk weights for low-rated senior securitisation exposures and capital cliff effects when transactions are subject to rating downgrades. The ASF requests clarity as to the rationale for a 'BB+' rated senior securitisation tranche being subject to a 1,250% risk weight when the BCBS risk weight for the same externally rated senior tranche ranges from 140%-160%. In the ASF's view, this is an extreme outcome in the name of simplicity.

1.1.2 Standardised Approach

We understand APRA has largely adopted the SA outlined in the Basel III Framework. The SA outlined by BCBS is intended to "include a backstop approach, a risk-weight floor to guard against model risk, and caps to capital requirements to ensure consistency with the general non-securitisation framework"[4].

An observation is that there is a discrepancy between the risk weights for different asset classes derived under the SA. This can be illustrated using the following example, comparing a senior exposure for an auto loan securitisation with that for a credit card securitisation. This assumes that ERBA cannot be used, due to private ratings being assigned:

[4] BCBS "Revisions to the Basel Securitisation Framework" December 2012 (**BCBS 2012 Document**), page 2

	Scenario 1	Scenario 2
Asset Class	Auto loans	Credit Cards
Assuming:		
Equivalent external rating	AAA	A
Credit Enhancement	10%	15%
Loss rate	2%	4%
Risk weight under Standardised Approach	108%	82%

While the credit card securitisation has a lower equivalent external rating, its risk weight calculated under the SA is lower than an auto securitisation exposure with a higher equivalent external rating. As such we seek APRA's feedback in relation to the apparent lack of correlation between asset classes under the SA where the current APS 112 risk weights are the same (i.e. auto loans and credit cards risk weights are both 100%).

1.1.3 Maximum capital charge

BCBS acknowledges that the risk-weight cap effectively exists in the Basel III Framework for a bank, such that "…the senior securitisation exposure could receive a maximum risk weight equal to the exposure weighted-average risk weight applicable to the underlying exposures"[5]. BCBS has also noted previously[6] that the risk weight caps under the SA allows "a bank (either originator or investor) to apply a 'look-through' approach to senior, non-rated securitisation exposures".

Comparing with the BCBS standards, it appears that the proposed APS 120 does not reflect the maximum capital charge provisions outlined by BCBS.

Therefore there are discrepancies with the calculation of risk weights for senior securitisation exposures under the proposed APS 120 such that the senior risk weight can exceed the risk weight of the standardised risk weights for the underlying asset.

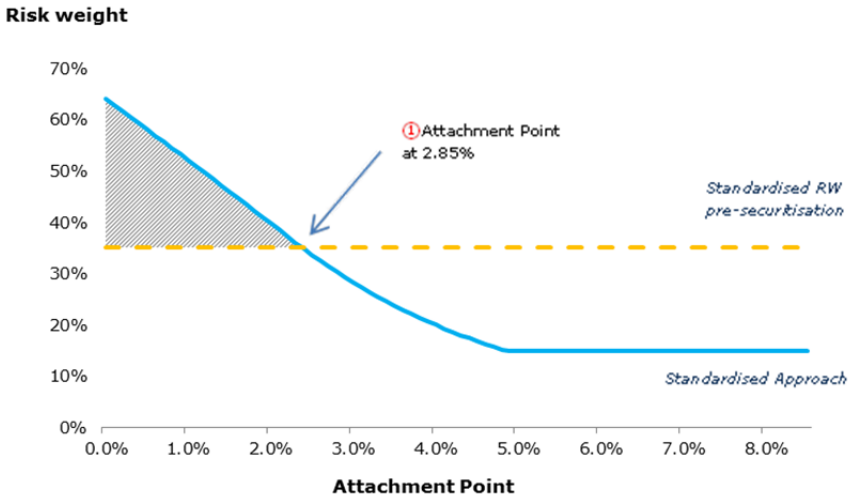
By way of illustration assuming the asset pool in the example below, the risk-weights for the senior securitisation exposure have been calculated at various attachment points:

Assume	
Asset class	Residential mortgage
Underlying asset RW	35% (Weighted Av LVR: 75%)
Tranche	Senior (Detachment point: 100%)
Delinquent exposures	0%
Maturity	5 years

The capital calculated under SA is greater than the standardised risk weight for a residential mortgage pre-securitisation where the attachment point is less than 2.85% (refer to ① in the graph below).

[5] Basel III Framework, paragraph 88: http://www.bis.org/bcbs/publ/d303.pdf
[6] BCBS 2012 Document, section IV page 32

Fig 1. Standardised Approach compared to standardised risk weight for residential mortgages



The proposed APS 120 (paragraph 61) partially addresses this, but only permits 'originating ADIs' to apply the 'look-through' approach to senior securitisation exposures[7]. This excludes ADIs investing in other transactions from using the 'look-through' approach, contrary to the approach set out in the Basel III Framework. We believe this unintended consequence in the proposed APS 120 will place many ADIs at a competitive disadvantage as investors in senior securitisation exposures. It also results in the seemingly illogical outcome where for example a highly rated senior securitisation tranche carries a higher risk weight than a 'naked' pool of assets. For example a 'AA-' rated senior RMBS instrument with all the structural enhancements (including third party credit enhancement) would carry a risk weight of 45%, yet a naked pool of residential mortgages in the example above would carry a risk weight of 35% under APS 112. The ASF believes this is an unintended consequence of the current proposals.

We recommend for global consistency, the maximum capital charge provision be applicable to senior tranches for all ADIs on the basis that:

- additional capital is still held by the junior noteholder; and
- it ensures at least the same amount of capital is retained in the banking system for the asset pool.

1.2 Recommended approach to the rating hierarchy

The ASF recommends the following hierarchy of rating approaches under the Basel III Framework:

1. Internal Ratings-Based Approach (**IRBA**) to be adopted by accredited ADIs;
2. External Ratings-Based Approach (**ERBA**);
3. Internal Assessment Approach (**IAA**), as a sub-set of ERBA, for approved asset classes to be adopted by accredited ADIs;
4. Standardised Approach.

[7] Proposed APS 120 paragraph 61

In addition to the comments relating to ERBA and SA in section 1.1, the relevance and applicability of the IRBA and IAA rating approaches are discussed in detail below. The ASF's feedback on other issues relating to non-senior exposures, derivatives and resecuritisation exposures are also contained in this section.

1.2.1 Internal Ratings-Based Approach

From an industry perspective, the IRBA is an important rating approach in order to ensure existing warehouse funding facilities, the provision of derivatives to securitisation transactions as well as ensuring that demand for securitisation is preserved. Implementation of IRBA would alleviate some of the consequences of higher regulatory capital charges flowing through both the Basel III Framework and implementation of a consistent framework by APRA for Australian ADIs.

The IRBA, whilst a conservative measurement of risk in a securitisation exposure, achieves a much more balanced outcome than either the ERBA or SA. The implementation of IRBA also upholds consistency with offshore regulations[8]. This will also ensure that Australian ADIs are not disadvantaged in competing with offshore ADIs (that are not required to adhere to Australian regulations) from the perspective of an investor or as a facility provider.

As noted by APRA, the SFA has been sparingly used under the current framework. Under the current APS 120, the hierarchy of regulatory capital approaches promotes the use of other approaches (ERBA and IAA) and as such this reduces the reliance of using SFA. In addition, the high standard set by APRA for IRB banks to be able to calculate K_{IRB} has made it difficult to apply the SFA to asset pools not originated by the ADI itself.

Under the Basel III Framework, IRBA allows ADIs (that are capable) to perform more granular assessment of the relevant risks associated with the securitisation exposures concerned. IRBA adopts a Simplified SFA, which is "simpler in design and would therefore be easier to use and supervise"[9]. The key inputs to the IRBA outlined in the Basel III Framework (compared to the ERBA and SA) are summarised below:

Key Input	IRBA	ERBA	SA
KIRB	■		
LGD	■		
Attachment Point	■		■
Detachment Point	■		■
Number	■		
Maturity Tenor	■	■	
External Rating of exposure		■	
KSA			■
W (Delinquency)			■

The only additional inputs required under IRBA are K_{IRB}, LGD and the number of exposures (N). It should be noted in an Australian context, LGD for residential mortgages are subject to a regulatory

[8] Greg Tanzer Commissioner of ASIC, speech to Australian Securitisation Forum (**ASF**) conference dated November 2013 referring to IOSCO's final report including "reviewing any differences that have a material adverse effect on cross-border transactions"
[9] BCBS "Revisions to the securitisation framework" Consultative Document p2, dated December 2013

floor which eliminates any model risk in the IRBA approach for this particular asset class. The ASF understands APRA may have some concerns with ADIs utilising internal models to calculate K_{IRB} in assessing the securitisation exposure for portfolios not originated by the ADI. The ASF submits that this is the position for every ADI globally which invests in a securitisation which securitises a portfolio of assets not originated by it.

The ASF also highlights that the Basel II framework[10] and Attachment D of APS 113 currently provides for an Advanced ADI's treatment of purchased receivables. Under this prudential standard it is noted that:

- a top down approach and estimates can be used to calculate PD and LGD estimates for portfolios not originated by the ADI;
- credit enhancement may or may not be provided for the purchased receivables. For the same asset pool under a securitisation, the credit risk of the senior tranche would be significantly lower than that for the naked pool;
- the minimum operational requirements under the Basel III Framework, APS 113 and APG 113 are less onerous than that for securitisation deals. Under APS 120, securitisation programmes are required to satisfy more rigorous conditions, including due diligence requirements.

The Basel III Framework also acknowledges that:

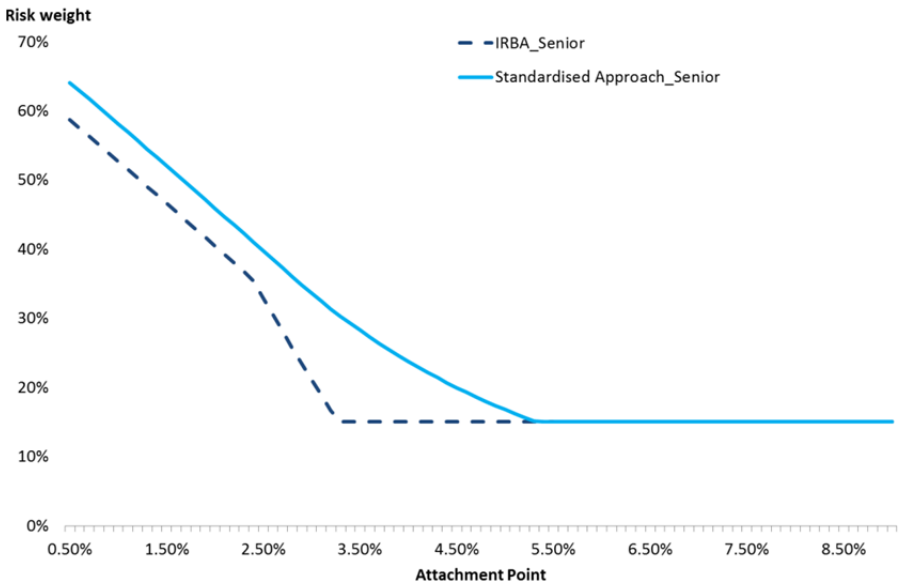
- a bank approved to adopt the IRB approach to calculate capital requirements for its underlying assets may calculate estimate capital requirements for the underlying assets within the securitisation exposures if it has sufficient information[11]; and
- in adopting an IRB approach, a 1.06 scaling factor is applied to broadly maintain the aggregate level of minimum capital requirements[12].

Given the vanilla nature of the Australian securitisation market, the ASF asks APRA to reconsider this position for retail exposures such as residential mortgages and auto/equipment receivables which have substantial historical data on which to base K_{IRB} assessments. To the extent the securitised assets are subject to an Advanced treatment by the ADI, it should flow that the IRBA can be used for a securitisation exposure which is collateralised by those same assets.

For illustrative purposes, the risk-weights between the IRBA and SA at various attachment points for a senior residential mortgage securitisation exposure are provided below. The K_{IRB} and LGD inputs assumed in this calculation are in line with APRA's announcement to increase capital adequacy requirements for residential mortgage exposures under the internal ratings-based approach[13].

[10] Section III F (para 362-373) of Basel II "International Convergence of Capital Measurement and Capital Standards: A Revised Framework – Comprehensive Version", www.bis.org/publ/bcbs128.htm
[11] Basel III Framework, paragraph 15
[12] Basel III Framework, paragraph 49 footnote 18, and pursuant to paragraph 44 of the Basel II framework
[13] APRA's announcement dated 20 July 2015

Assume	
Asset class	Residential mortgage
Underlying asset RW	35% (Weighted Av LVR: 75%)
Tranche	Senior (Detachment point: 100%)
Delinquent exposures	0%
Maturity	5 years



IRBA operational requirements

The ASF also appreciates that APRA may have concerns in relation to the operational burden of implementing IRBA given:

- the need for supervisory consistency (in particular in the assessment of IRB models). Internal models require detailed discussions which can be time consuming yet surveillance of IRBA must be performed in a timely and consistent manner; and
- the cost of compliance, including pressures on resources, for APRA and ADIs.

From this perspective, the ASF recommends potential solutions may include:

- outlining a roadmap for the implementation of regulatory review of internal models, similar to that issued by the European Banking Authority (**EBA**)[14]. This may include APRA carrying out benchmarking exercises to ensure consistent implementation and a harmonised disclosure framework in order to facilitate comparison between ADIs; and
- an external third party who holds skill of regulation to verify internal models. For example an audit firm providing an opinion that confirms its analysis aligns with the standard on IRBA K_{IRB} proxies.

[14] EBA issuing an Opinion and Report "The EBA's regulatory review of the IRB approach" specifying the general principles and timelines for the implementation of the regulatory review of IRB, dated 4 February 2016

1.2.2 Internal Assessment Approach (IAA)

The IAA has been successfully employed in the current APS 120. We recognise that APRA departed from the Basel II framework by extending the application of the IAA beyond ABCP, however this is consistent globally in that most warehouse facilities are provided via ABCP in offshore jurisdictions (for which IAA is utilised) and balance sheet facilities in Australia, where IAA has been used. Major banks have spent significant time and resources in developing their respective IAAs. Whilst only APRA sees all the ADIs' methodologies and results, we understand that the methodologies have been robust and are strongly embedded in the ADIs' risk processes. The BCBS Consultation Paper states that "[i]n addition, [the framework] should give incentives to improve risk management by assigning capital charges using the best and most diverse information available to banks." From the experience of the contributors to this ASF submission, the IAA has allowed Advanced ADIs not to rely mechanistically on external ratings in their securitisation assessment.

We support APRA's recognition of IAA in the Australian environment and continued recognition of IAA under the Basel III Framework where IRBA may not be applicable.

For some of the approved asset classes under the IAA, the ASF has been advised that it will be difficult to calculate and supervise K_{IRB} given the lack of comparability across industries and internal bank data available to benchmark K_{IRB} assessment.

With the IAA approval granted to the Advanced ADIs, APRA has assessed each bank's ability to perform similar analyses for assets such as trade receivables. On this basis, it follows that we support APRA's approach to permit IAA to be used for asset classes that cannot adopt IRBA. Noting the IAA has been used extensively in the industry with controls established to monitor its performance, the ASF does not understand the drivers for discontinuing the use of the IAA in the Basel III Framework. The ASF submits that, given the nature of asset classes for which the IAA is approved under the current APS 120, an Australian-specific use of IAA is justified.

The ASF understands that existing IAA assessments may need to be recalibrated to factor in elements of paragraphs 75-76 of the Basel III Framework and be modified to factor in tranche maturity in risk weight look-ups.

1.2.3 Non-senior securitisation exposures

APRA has proposed a CET1 deduction for all non-senior securitisation exposures reflecting its view that these exposures are akin to holding an equity position. The ASF does not agree with this proposal and notes that not all non-senior tranches are akin to equity-like positions and therefore such a punitive capital charge is not justified for all non-senior exposures. In an attempt to simplify the prudential approach, the ASF believes that risk sensitivity has been sacrificed when potentially the drivers for imposing CET1 deductions have been made redundant by the market changes since APRA first flagged its desire to see non-senior tranches be treated as CET1 deductions in November 2013 (for example, rating agencies no longer provide 100% credit to LMI in RMBS therefore requiring RMBS deals to be structured with an unrated equity tranche which is not placed with other ADIs).

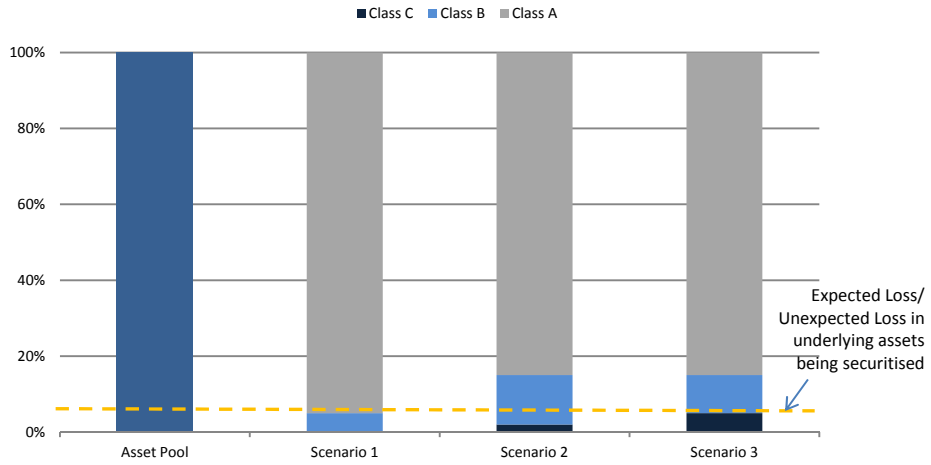
The credit risk of an asset pool reflects the expected loss (**EL**) and unexpected loss (**UL**) based upon the quality of assets within the pool, and the level of this risk is not driven by the capital structure of a securitisation. In the case of residential mortgages, it is not materially driven by the level of LMI cover available on the mortgage pool. On the other hand, credit risk for a securitisation exposure is dependent on the risk profile of the underlying assets, as well as the thickness of that tranche and its

position within the capital structure. A securitisation tranche may be non-senior however it may not be exposed to material credit risk (i.e. EL/UL) of the pool.

For example, an asset pool securitised for capital relief purposes with a number of non-senior tranches can be structured with different attachment and detachment points. While the credit risk attached to the pool will not change, the credit risk relating to each securitisation exposure will depend on its position within the capital structure. In the graph below, assuming a residential mortgage pool has EL/UL at 5%, the non-senior tranches are exposed to EL/UL in Scenario 1 and 2. However, Scenario 3 shows that the mezzanine tranche is not exposed to EL/UL. As such, it follows that the mezzanine tranche (Class B) in Scenario 3 is not at all akin to an equity position.

Fig 2. Credit risk to an asset pool remains unchanged regardless of the capital structure

% of pool	Scenario 1	Scenario 2	Scenario 3
Class A	95%	85%	85%
Class B	5%	13%	10%
Class C	-	2%	5%
Total	100%	100%	100%



In other words, certain tranches (e.g. Class B in Scenario 3) can be non-senior but still not be materially exposed to the credit risk of the asset pool.

We appreciate APRA's concern in relation to contagion risk in the financial system when an ADI takes on credit exposures originated by other ADIs. Also we understand APRA's objective to transfer credit risk out of the banking industry. Higher capital charges for non-senior tranches over senior tranches aim to discourage ADIs from holding non-senior exposures (as outlined in the Basel III Framework). However a CET1 capital charge for all non-senior exposures under the proposed APS 120 is arbitrary, overly onerous, and disproportionate to the credit risk profile of the tranche.

The impact of the proposed CET1 capital charge will be to remove Australian ADIs as investors in any non-senior securitisation tranche. However, as discussed above, recent years have seen offshore banks and real money investors reduce their involvement in the Australian securitisation market. The results of imposing a CET1 deduction on Australian ADIs investing in mezzanine tranches of securitisations (such as Class B in Scenario 3 above) is that smaller Australian ADIs and NBFIs have to either retain these non-senior tranches themselves or pay away higher coupons to the remaining investors in these tranches. In either case this results in greater funding costs for smaller ADIs, with

negative impacts on competition in those assets (in particular residential mortgages) and competitive neutrality. The absence of Australian ADIs from the investor base for such mezzanine tranches also means a meaningful reduction in liquidity.

With the benefit of a now finalised BCBS position for the hierarchy of approaches to assess a securitisation exposure, the ASF recommends APRA reconsider its position for non-senior tranches. The ASF's strong preference is to align the applicable risk-weights for non-senior tranches in the proposed APS 120 to the Basel III Framework as this strikes an appropriate balance in an Australian context between prudent risk management and competition and positions Australian ADIs on a level playing field domestically and internationally.

We understand a number of industry participants will provide APRA with views on the treatment of non-senior tranches in the context of the Basel III Framework. Noting APRA's reluctance to adopt the Basel III Framework for non-senior risk weights, it is the ASF's view that once APRA has digested industry feedback on this subject, specialist members of the ASF to continue to work with APRA to develop a risk-sensitive Basel-consistent approach.

1.2.4 Regulatory capital treatment of derivatives

We also seek confirmation that the risk weights for market risk hedges such as currency or interest rate swaps will be inferred from a securitisation exposure that is *pari passu* to the swaps or, if such an exposure does not exist, from the next subordinated tranche. This will be consistent with the Basel III Framework[15] and, we believe, is the intention of paragraph 55(a) of the proposed APS 120 - "the reference securitisation exposure…cannot be senior in any respect to the unrated securitisation exposure". Clarification of this point, either by minor redrafting of paragraph 55 or in the proposed prudential practice guide, will avoid any potential misinterpretations in calculating regulatory capital.

1.2.5 Resecuritisation exposures

Materiality threshold for resecuritisation exposures held by a securitisation

The ASF notes APRA's intention to treat all resecuritisation exposures as CET1 deductions. The ASF understands APRA's objectives in this regard however would request APRA amend its definition of 'resecuritisation exposure' to include a materiality threshold when assessing the securitisation position for capital purposes. The ASF submits that an exposure should only be deemed a resecuritisation exposure if the securitisation invests more than 5% of its assets in another securitisation/s. For all 'resecuritisation exposures' that do not breach this threshold, the Basel III Framework should be adopted as regards the capital treatment for that resecuritisation exposure. This amendment would ensure that minor investments to manage liquidity within a securitisation do not result in senior tranches of vanilla securitisations being treated as CET1 deductions.

Asset-backed commercial paper

The ASF seeks clarity on the potential interpretation of ABCP exposures as resecuritisations. ABCP conduits, particularly multi-seller conduits, often involve exposures to multiple SPVs, and we therefore seek clarification on the following:

(a) is an ABCP conduit itself considered a securitisation if cash flows from the pool(s) are

[15] Basel III Framework, paragraph 86

used to make payments to only one class of creditors? ABCP conduits can be structured such that the liquidity facility and ABCP holders rank pari-passu from a credit perspective, and could therefore be treated as a non-securitisation. Clarification on this point would mean that ADIs providing liquidity facilities to conduits that acquire senior notes from multiple trusts can be treated as a securitisation rather than a resecuritisation; and

(b) if an ABCP conduit acquires a note from a un-tranched RMBS trust, the note acquired by the ABCP conduit would not be deemed to be a securitisation. Clarification on this point would mean that ADIs providing liquidity facilities would be treated as a securitisation rather than a resecuritisation.

1.3 STC securitisation

As noted above, the ASF supports the initiatives by the BCBS on STC securitisation as set out in the consultative document released by the BCBS in November 2015. Attached as Annex I to this paper is the recent ASF submission to the BCBS on the STC securitisation consultative document. The ASF supports the principles of designating certain securitisations as being STC in the context of preferential regulatory capital treatment being applied to such transactions and the ASF welcomes the implementation of the STC approach in Australia by APRA once the BCBS has finalised its STC proposals. To the extent the BCBS set an implementation date for STC which is aligned to the implementation date for the Basel III Framework, i.e. January 2018, it is the ASF's strong preference that revised risk weights attaching to Australian STC compliant transactions be implemented by January 2018. Non alignment will place Australian issuers and investors at a material disadvantage to offshore equivalents.

2. Revolving securitisation

The ASF welcomes the introduction of the revolving securitisation provisions in the proposed APS 120 and appreciates the dialogue to date with APRA on revolving securitisations. Set out below are sections of the revolving securitisation provisions in the proposed APS 120 that the ASF requests confirmation as regards the interpretation of with APRA. The ASF anticipates these are technical clarifications only.

2.1 Revolving period – seller interest

The reference to the originating ADI's seller interest in paragraph 8 of Attachment B of the proposed APS 120 should not include reference to the ADI's subordinated interest. The ASF expects that a revolving securitisation would comprise senior securities held by the originating ADI and investors; and subordinated securities held by the originating ADI. The senior securities held by the originating ADI would not be subordinate to senior securities held by investors with respect to cash flows (interest payments and expenses) or losses (although principal cash flows may be paid on senior securities held by investors ahead of principal cash flows paid on senior securities held by the originating ADI in the ordinary course, depending on principal allocation. The ASF understands APRA is comfortable with such principal allocation in the ordinary course.) However junior securities held by the originating ADI in a revolving securitisation would be subordinate to all senior securitisation exposures with respect to all cash flows and losses. The definition of seller interest in the proposed APS 120 currently picks up both senior and junior securities held by the originating ADI rather than just the senior securities. As the definition of seller interest is only used in paragraph 8 of Attachment B of proposed APS 120, this definition may be deleted on the basis that revolving securitisations are simply structures comprising senior and junior securities.

As well, in the context of paragraph 20(b) of proposed APS 120 which states that an originating ADI must not increase a retained first loss position or provide additional credit enhancement after the inception of the transaction, except as otherwise provided in Attachment B, the ASF would like clarification to be included in Attachment B that in a revolving funding-only securitisation where additional junior securities will be issued to the originating ADI from time to time which provide credit enhancement to senior securitisation exposures on a pooled basis, the provisions of paragraph 20(b) will not be breached. In addition, where junior securities are issued on a series (as opposed to pooled) basis as credit enhancement for senior securities of that particular series only, the ASF requests clarity whether it would be acceptable, in light of paragraph 20(b), to size junior securities having regard to the required credit enhancement levels at that the time of issuance (which may increase or decrease over time) independently of any other junior securities issued in support of other series. The ASF requests the opportunity to continue discussions with APRA in regard to these points.

2.2 Revolving period – scheduled or early amortisation and similar provisions

2.2.1 In the context of footnote 30 to paragraph 9(c) of Attachment B of proposed APS 120, the ASF would like the reference to pro rata payments to the originating ADI and investors to be qualified by reference to the senior securitisation exposures held by the originating ADI only, for the reasons outlined in our comments in paragraph 2.1 above.

It is expected that any pay-out arising from early amortisation or similar provisions would be paid pro rata to all senior securitisation exposures first, with junior securities being paid out only after all senior securitisation exposures had been repaid in full.

2.2.2 In the context of paragraph 10 of Attachment B of the proposed APS 120 (and the related provisions of paragraph 9 of Attachment B of APS 120), could APRA please confirm whether the restriction on adding new exposures to the pool is intended to capture revolving receivables in respect of which all exposures (including any future draws under those receivables) have already been assigned to the SPV. This is being considered in the context of exposures, such as credit cards, where the ADI is contractually bound to continue funding future draws by customers on credit cards on an on-going basis, including following an amortisation or similar event. In recent discussions, it seemed that APRA would be open to revisiting this in the context of revolving receivables securitisations (such as credit cards) and the ASF would welcome the opportunity to discuss the cash flows and other considerations in this regard further with APRA. As noted above, the ASF proposes to separately submit a detailed master trust term sheet to illustrate the cashflow waterfalls and variability of the seller share for credit cards.

2.2.3 The ASF notes that the term "scheduled amortisation" is used in conjunction with "early amortisation" in a number of provisions of the proposed APS 120 including paragraphs 9 and 10 of Attachment B. The ASF submits that it is not appropriate to do so as the two concepts are different. Maximum flexibility to adopt a principal repayment profile for senior securities to be issued to investors under a revolving funding-only securitisation is preferred so as to ensure to attract investor interest; to allow capacity to tailor the repayments to meet investor appetite; and potentially manage any hedging requirements more cost effectively. It is expected that the principal repayment profile of investor senior securities is most likely to be pass through or soft bullet but should not preclude scheduled amortisation unless there is a legitimate reason to do so – we contend that there is not. A scheduled amortisation payment profile is to be distinguished from an early amortisation provision (or similar provisions such as controlled amortisation events). Under a scheduled amortisation, it is agreed at the outset as to the date upon which principal repayments will be made whereas under an early amortisation provision, the principal repayment of the securities is accelerated as a result of certain events being triggered. Accordingly, the ASF requests that the reference to "scheduled amortisation" in the proposed APS 120 be removed.

2.3 Removal of 20% securities holding limit

The ASF understands from past discussions with APRA that APRA intends to remove the current restriction in paragraph 8 of Attachment F of APS 120 on an originating ADI holding 20% or more of securities issued by an SPV. We note there is discussion of this point in paragraph 2.2.2 of the Discussion Paper in the context of trading in securities.

In the context of revolving funding-only securitisations, the originating ADI would likely hold more than 20% of all securities issued and outstanding and potentially more than 20% of senior securities issued and outstanding in order to facilitate different maturities and repayment profiles (e.g. soft bullet, scheduled amortisation and pass through) of senior securities sold to third party investors. As well, in the context of a funding-only securitisation (revolving or otherwise), the holding of junior securities acquired by an originating ADI at issuance may increase above 20% of both junior securities and all securities outstanding as the securitisation transaction amortises.

As none of the scenarios discussed above constitute trading in such securities or the provision of implicit support, the ASF would like to confirm with APRA that in the context of senior or junior securities acquired by the originating ADI at issuance of those securities in a funding-only securitisation (whether or not a revolving securitisation) there will be no limit on securities held by the originating ADI, including where the proportion of securities held by an originating ADI increases as a securitisation amortises.

Following discussions with APRA, the ASF understands that any holding limit in the context of a revolving funding-only securitisation is not intended to be a hard and fast rule which, if breached, would result in a breach of the standard. In addition, it is our understanding that any holding limit will only apply with respect to senior securities and not junior securities in a funding-only securitisation (whether revolving or otherwise) that may be held by the originating ADI. Further clarification in the proposed APS 120 or the associated practice guide on these points would be welcomed.

2.4 Definition of "senior securitisation exposure"

In the context of footnote 2 to the definition of "senior securitisation exposure" in the proposed APS 120, could APRA please confirm what this footnote is addressing (e.g. credit risk mitigation)? The ASF would like to see footnote 2 clarified so that it is clear any currency or interest rate hedging by an ADI and the SPV in respect of a particular tranche of senior securities does not result in the provisions of footnote 2 applying. It is required that an ADI enter into hedging transactions with the SPV issuer in respect of particular tranches of securities (e.g. where a transaction has a particular foreign currency tranche issued).

2.5 Call date set at inception

In the context of paragraph 5(d) of Attachment B of the proposed APS 120, the ASF would like the reference to the call date being set at inception in sub-paragraph (i) to be clarified to state that the call date for a particular tranche of notes is set at issuance (rather than inception of the programme or transaction).

3. Capital relief transactions

3.1 Significant credit risk transfer

The ASF appreciates APRA's decision to retain the significant credit risk transfer approach for determining capital relief and supports the quantitative thresholds specified in the Discussion Paper and the proposed APS 120.

3.2 Election of securitisation as capital relief or funding-only

3.2.1 The ASF notes that paragraph 72 of proposed APS 120 provides that:

(a) the originating ADI must designate a securitisation at inception as capital relief or as funding-only; and

(b) the originating ADI must not switch the treatment of such securitisation from capital relief (if so designated at inception) to funding-only.

3.2.2 The ASF would appreciate confirmation from APRA that the "inception" of a securitisation is the date on which the securities are first issued in connection with the securitisation.

3.2.3 The ASF would also welcome clarification from APRA as to its view of the prudential consequences (from an APS 120 perspective) of:

(a) the originating ADI structuring and marketing a transaction as capital relief (for example, by including a B1 and a B2 class of junior securities which are credit tranched); and

(b) due to market or other factors, the originating ADI being unable to sell 80% or more of either, or both, the B1 and B2 class of junior securities.

3.2.4 In particular, the ASF notes that at inception:

(a) the securitisation would not meet the quantitative threshold for when significant credit risk is deemed to occur (as specified in paragraph 2 of Attachment A of proposed APS 120); and

(b) the securitisation would not meet the funding-only requirement that there is no credit tranching of the junior securities (as specified in paragraph 1 of Attachment A of proposed APS 120).

3.2.5 Having regard to a number of relevant factors, including:

(a) reputational issues and the cost and timing consequences of any restructure and/or remarketing of the securitisation;

(b) system update issues associated with changes to the capital structure (including for the purposes of generating RBA reports which are needed for compliance with the RBA's repo eligibility requirements); and

(c) material and adverse investor implications (for example, having regard to the time and cost incurred by such investors in assessing the existing structure),

the ASF submits that, as a practical matter, it would not be possible for the originating ADI to withdraw the securitisation from the market pending a restructure of the junior securities to achieve compliance with the funding-only requirement as to no time or credit tranching.

In practice, there is typically a very short period of time (often less than one week) between the marketing phase of a transaction and pricing/settlement of the relevant securities. Once a transaction has been assigned preliminary credit ratings and marketed to investors based on a specific capital/tranche structure, there is no realistic opportunity to alter that capital/tranche structure (or other key structural terms and/or features). Further altering the transaction structure of a securitisation between the time that investors have reviewed a preliminary information memorandum and the closing date could risk the ADI being in breach of securities laws requirements with respect to marketing securities under a misleading offering document. For this reason, any change to a transaction structure following marketing would likely require the withdrawal of the offer and the implementation of a new offering.

3.2.6 The ASF proposes that, in the circumstances contemplated by paragraph 3.2.3 above:

(a) the ADI should be entitled to retain the designation of the securitisation as "capital relief";

(b) the originating ADI should not be entitled to obtain regulatory capital relief at inception of the securitisation; and

(c) the originating ADI may only claim regulatory capital relief if it is able to subsequently sell the retained securities in a manner consistent with the capital relief requirements under the proposed APS 120.

3.3 Capital relief for revolving structures

3.3.1 The ASF would appreciate clarification being included in the proposed APS 120 that a securitisation that is structured to achieve:

(a) significant risk transfer; and

(b) funding for a period of not less than the maturity of the underlying exposures in the pool (i.e. so there is no asset-liability mismatch),

can achieve capital relief for the originating ADI where the securitisation has:

(c) a revolving period where new exposures may be added to the underlying pool (funded by additional funding or collections on the pool);

(d) amortisation triggers (pool performance triggers and non-extension of the revolving period) which stop the revolving period; and

(e) mechanics whereby the revolving funding period may be extended on terms to be agreed by the parties to the securitisation, including the originating ADI (such terms may include an extension of the funding maturity date and pricing of the securitisation facility). Importantly if the revolving funding period is not extended,

the securitisation amortises on pre-agreed terms however the maturity of the pool exposures and the securitisation funding continues to be matched.

3.3.2 The ASF seeks this clarification on the understanding that APRA is open to capital relief being achievable in the scenario outlined above and the ASF notes the following aspects of the Discussion Paper and the proposed APS 120 which suggest that such capital relief may not be achievable:

(a) Page 8 of the Discussion Paper states "…requiring term securitisations as a pre-condition for regulatory capital relief…"

(b) Page 22 of the Discussion Paper states "… the nature of the renegotiation of the terms of warehouse funding at the notional expiry of the arrangement has pointed to a true sale not having occurred."

(c) Page 22 of the Discussion Paper states "In practice, this means any pool that requires rollover or refinancing will be ineligible for capital relief."

Securitisation transactions can be structured so that rollover or refinancing is not required. Rather the revolving period, final maturity date and pricing for funding are extended as agreed between the originating ADI and the financier. This extension process for the revolving period and, if required, final maturity date should not impact capital relief to the extent that the assets already funded continue to be match funded even where the extension is not agreed.

(d) The definition of "revolving securitisation" as drafted under the proposed APS 120 may capture the above described securitisation with a revolving period that may be extended. The ASF notes that "revolving securitisations" are unable to achieve capital relief under the proposed APS 120. Accordingly, the ASF would appreciate clarification that the above described securitisation with a revolving period is excluded from the definition of revolving securitisations.

3.4 Tranching of funding-only securitisations

3.4.1 The ASF notes that:

(a) APRA does not propose to allow for time or credit tranching of the junior securities in a funding-only securitisation; and

(b) APRA's stated objective is to achieve clarity and simplicity in a funding-only securitisation.

3.4.2 The ASF acknowledges that APRA has expressed this view with the benefit of previous submissions on this topic in connection with the 29 April 2014 Discussion Paper. However, the ASF is hopeful that the proposed approach, in respect of this topic, remains subject to adjustment based on further industry feedback and consultation.

3.4.3 It is the ASF's experience that investors do not regard typical Australian, multi-tranched, securitisation structures as being complex and that there is not a direct correlation between additional tranching and the complexity of a structure. The ASF submits that the majority of Australian ADI securitisations are, in fact, relatively vanilla and that the inclusion of more

than 2 tranches of securities does not, of itself, compromise the objective of simplicity.

3.4.4 Please consider an example auto ABS deal which may require 13% credit enhancement to achieve a 'AAA' rating:

(a) the originating ADI may wish to issue mezzanine 'AA' rated securities which may only require 8% credit enhancement thus providing 5% more funding against the underlying securitisation exposures;

(b) the junior tranche for the bottom 8% of the securitisation would be retained by the originating ADI thus failing the significant risk transfer test for capital relief.

Structuring this securitisation as a three tranche funding-only transaction adds, in the ASF's view, no discernible additional complexity, yet provides the originating ADI with additional funding against the same underlying exposures – with the marginal price of the mezzanine tranche likely to produce a more cost efficient outcome for the originating ADI relative to alternative sources of funds.

4. Trust Back Arrangements

4.1 Trust Back Arrangements

4.1.1 In response to the 2014 Discussion Paper, the ASF submitted that the rights and protections afforded to the ADI under a typical trust back arrangement in relation to a mortgage over real property securing both a securitised loan and a retained loan (a "**Trust Back Arrangement**") provide equivalent rights and protections to those which the ADI would have as the holder of a formal second mortgage (a "**Formal Second Mortgage Arrangement**").

4.1.2 The ASF understands that APRA retains reservations as to the effective equivalence, in all scenarios, of Trust Back Arrangements when compared to Formal Second Mortgage Arrangements. The ASF understands that such reservations may include concerns as to the ADI's entitlements following the occurrence of a title perfection event.

4.1.3 The ASF requests APRA to further consider this issue and, for this purpose, provides a comparative analysis regarding:

(a) the ADI's entitlement to enforcement proceeds under a Trust Back Arrangement compared to a Formal Second Mortgage Arrangement; and

(b) the rights afforded to the ADI under a Trust Back Arrangement compared to a Formal Second Mortgage Arrangement, including following the occurrence of a "title perfection event" (where the relevant securitisation vehicle perfects its title to the securitised loan and mortgage).

4.1.4 In summary, the ASF suggests that not only are the relevant rights of the ADI under the Trust Back Arrangement at least the equivalent of its rights under the Formal Second Mortgage Arrangement – in the ASF's view, certain of the ADI's rights under the Trust Back Arrangement are incrementally more favourable than under a Formal Second Mortgage Arrangement. More specifically:

(a) under a Formal Second Mortgage Arrangement the rights of the first ranking mortgagee prevail over the rights of the second ranking mortgagee (see paragraphs 4.4.1 – 4.4.4 below);

(b) whereas, under a Trust Back Arrangement, the professional independent trustee company ("**Trustee Company**") remains obliged to act in accordance with any direction given to it by the relevant ADI (including where the relevant mortgage has been registered in the name of the Trustee Company following the occurrence of a title perfection event) (see paragraphs 4.2.1(d) and 4.4.8 below). That is, in the ASF's view, the relevant ADI has contractual entitlements to control the enforcement of the relevant mortgage which are, in practical terms, more favourable to the ADI than the rights afforded to it as the holder of a second ranking mortgage.

4.2 Features of a typical Trust Back Arrangement

4.2.1 Under a typical Trust Back Arrangement:

(a) a customer grants a mortgage ("**shared mortgage**") in favour of an ADI, which secures two loans:

(i) the "securitised loan" – being the loan sold by the ADI to the relevant securitisation trust; and

(ii) the "retained loan" – being the loan retained by the ADI;

(b) in connection with the relevant securitisation, the Trustee Company declares that it holds all "Trust Back Assets" on trust solely for the ADI;

(c) the "**Trust Back Assets**" include an interest in the shared mortgage (for example, to the extent it secures the relevant retained loan);

(d) pursuant to the terms of the trust back arrangement:

(i) the Trustee Company is required to act in accordance with any direction given to it by the ADI in respect of the Trust Back Assets (subject to limited exceptions, such as the Trustee Company not being obliged to act if it considers it would be illegal to do so);

(ii) if the ADI is no longer the Servicer, the Servicer agrees to enforce the shared mortgage upon receipt of a direction to do so from the ADI that the retained loan is in default;

(e) the terms of a typical Trust Back Arrangement also require the Trustee Company to distribute such proceeds in accordance with the prescribed order of priority. That order of priority is typically:

(i) first, to meet all costs, charges and expenses of the Trustee Company or the relevant mortgagee or any receiver, receiver and manager or money incurred in the enforcement of the shared mortgage;

(ii) next, in satisfaction of amounts which are payable or owing under the securitised loan, to be held on the terms of the securitisation trust; and

(iii) next, to the ADI in satisfaction of the retained loan.

4.3 Equivalent entitlement to enforcement proceeds

4.3.1 Under the Torrens system, priority between two real property mortgages will depend on the order of registration.

4.3.2 Where the relevant land is the subject of two registered real property mortgages, any proceeds of sale received by the relevant mortgagee in connection with the enforcement of that mortgage must be applied by it in the order prescribed by law.

4.3.3 For example, section 58(3) of the Real Property Act 1900 (NSW) requires proceeds of the sale of the relevant land to be applied in the following order of priority:

(a) first, in payment of expenses occasioned by the sale;

(b) second, in payment of moneys then due or owing to the relevant mortgagee;

(c) third, in payment of subsequent mortgages in the order of their priority; and

(d) fourth, the surplus (if any) shall be paid to the mortgagor.

4.3.4 To illustrate the above, please consider the following "Formal Second Mortgage Arrangement" example:

- Obligor owes $100 to Bank A.
- Obligor owes $30 to Bank B.
- Bank A holds a first ranking registered mortgage over Obligor's land.
- Bank B holds a second ranking registered mortgage over Obligor's land.
- Bank A becomes entitled to enforce its first ranking mortgage. Bank A exercises its power of sale and sells the land for $150. The costs of enforcement are $5.

4.3.5 Pursuant to section 58(3) of the Real Property Act 1900 (NSW), Bank A must apply the $150 of enforcement proceeds in the following order of priority:

(a) first, $5 - in payment of the costs of enforcement;

(b) second, $100 to Bank A - in payment of moneys then due or owing by the Obligor to Bank A;

(c) third, $30 to Bank B - in payment of moneys then due or owing by the Obligor to Bank B; and

(d) fourth, $15 to the Obligor – in payment of the surplus proceeds.

4.3.6 By way of comparison, please consider the following "Trust Back Arrangement" example:

- Obligor owes $100 to Bank A pursuant to a variable rate loan (the "securitised loan").
- Obligor owes $30 to Bank A pursuant to a fixed rate loan (the "retained loan").
- Bank A holds a first ranking registered mortgage over Obligor's land, which secures both the variable rate loan and the fixed rate loan (that is, the "shared mortgage").
- pursuant to the securitisation:
    - Bank A equitably assigns the variable rate loan to the Trustee Company (in its capacity as trustee of the relevant securitisation trust); and
    - Bank A equitably assigns the first ranking mortgage to the Trustee Company for the benefit of the relevant securitisation trust but subject to the terms of the Trust Back Arrangement.

- Trustee Company becomes entitled to enforce the first ranking mortgage. Trustee Company (or the Servicer on its behalf) exercises its power of sale and sells the land for $150. The costs of enforcement are $5.

4.3.7 Pursuant to the order of priority described in paragraph 4.2.1(e) above, under the Trust Back Arrangement all moneys received from enforcement must be applied as follows:

(a) first, to meet all enforcement costs of the relevant mortgagee or any receiver, receiver and manager or attorney – that is, $5;

(b) next, in satisfaction of amounts payable under the securitised loan – that is, $100 to the Trustee Company (on behalf of the securitisation trust) - in payment of moneys then due or owing by the Obligor under the variable rate loan;

(c) next, in satisfaction of amounts payable under the retained loan – that is, $30 to Bank A - in payment of moneys then due or owing by the Obligor to Bank A under the fixed rate loan; and

(d) next, any balance returned to the mortgagor – that is, $15 to the Obligor.

4.3.8 That is, the example in paragraphs 4.3.6 and 4.3.7 above (for a Trust Back Arrangement) results in the **same** allocation of proceeds as the example in paragraphs 4.3.4 and 4.3.5 above (for a Formal Second Mortgage Arrangement). The following table summarises the above examples:

	Trust Back Arrangement	**Formal Second Mortgage Arrangement**
Example	• Obligor owes $100 to Trustee Company under the **securitised loan**. • Obligor owes $30 to Bank under the **retained loan**. • Bank holds first registered mortgage	• Obligor owes $100 to Bank A (being, for comparison purposes, the equivalent of the **securitised loan**) • Obligor owes $30 to Bank B (being, for comparison purposes, the equivalent of the **retained loan**) • Bank A holds first registered mortgage • Bank B holds second registered mortgage
Sale proceeds	$150	$150
Enforcement costs	$5	$5
Priority of application of sale proceeds	• First – $5 in payment of enforcement costs. • Second - $100 to Trustee Company • Third - $30 to Bank • Fourth - $15 to Obligor	• First – $5 in payment of enforcement costs. • Second - $100 to Bank A • Third - $30 to Bank B • Fourth - $15 to Obligor

4.3.9 Accordingly, the ASF submits that under a Trust Back Arrangement, the ADI has a first claim to any excess proceeds from the shared mortgage once all amounts payable under the relevant securitised loan (to which that shared mortgage relates) have been repaid. In the ASF's view, this effectively produces the same economic outcome as if the ADI had the benefit of a second registered mortgage.

4.3.10 For completeness, the ASF notes that the issue of "title perfection" (described in paragraph 4.4.7 below) is not a relevant consideration in the context of the above analysis. That is, the order of priority of entitlement to enforcement proceeds is unaffected by whether or not title to the shared mortgage has been perfected.

4.4 Equivalent enforcement rights

4.4.1 Please again consider the above "Formal Second Mortgage Arrangement" example whereby:

- Bank A holds a first ranking registered mortgage over Obligor's land; and
- Bank B holds a second ranking registered mortgage over Obligor's land.

4.4.2 The contractual and statutory remedies of enforcement are available to Bank B. However, the exercise of the power of sale is, as a matter of law, subject to the rights of Bank A.

4.4.3 Specifically:

(a) Bank B cannot effect a sale of the Obligor's land free of the interest of Bank A; and

(b) the priority afforded to Bank A is a priority of rights. If Bank A elects to enforce its own right of sale under its first ranking mortgage, that right will prevail. Bank A and not Bank B will control the enforcement process.

4.4.4 Broadly, what this means in practice is as follows:

(a) a third party purchaser is highly unlikely to purchase land (pursuant to a sale by a second ranking mortgagee) which remains the subject of a first ranking mortgage;

(b) any purported enforcement action against the relevant land (by the second ranking mortgagee) would trigger a default under the first ranking mortgage;

(c) the first ranking mortgagee will control the enforcement process and will distribute the proceeds of enforcement in the order prescribed by law.

4.4.5 Please again consider the "Trust Back Arrangement" example whereby:

- Bank A equitably assigns the first ranking mortgage to the Trustee Company (the "shared mortgage");
- the Trustee Company holds the shared mortgage for the benefit of the relevant securitisation trust but subject to the terms of the Trust Back Arrangement.

4.4.6 Typically the securitisation will involve:

(a) an equitable assignment of the shared mortgage from Bank A to the Trustee Company – with Bank A remaining as the registered mortgagee; and

(b) the Trustee Company only being permitted to perfect its legal title to the shared mortgage (including effecting a registered transfer of the shared mortgage from Bank A to the Trustee Company) upon the occurrence of a limited number of agreed "title perfection events".

4.4.7 Accordingly, prior to any such "title perfection event", Bank A (in its capacity as servicer of the securitisation trust and as registered mortgagee) will take the relevant enforcement action on behalf of the Trustee Company.

4.4.8 Following any such "title perfection event", the Trustee Company (as the registered mortgagee) will take the relevant enforcement action on its own behalf. However, as noted above, in accordance with the express terms of the Trust Back Arrangement, the Trustee Company will be required to act in accordance with any direction given to it by Bank A in respect of the shared mortgage and the Servicer will be required to enforce the shared mortgage where the ADI is no longer the Servicer if the retained loan is in default. That is, although the ADI may no longer be the registered mortgagee, it retains the right to compel enforcement of the shared mortgage (in the ASF's view, that right is for all practical purposes at least the equivalent of a second registered mortgage, noting the priority of rights afforded to a first ranking mortgagee as described above).

4.4.9 The following table summarises the above examples:

	Trust Back Arrangement	**Formal Second Mortgage Arrangement**
Example:	Bank assigns first registered mortgage to Trustee Company.	Bank A holds first registered mortgage. Bank B holds second registered mortgage.
Enforcement rights	Prior to a "title perfection event" the Bank as servicer will exercise the enforcement rights on behalf of Trustee Company. Following a "title perfection event" the Trustee Company will exercise the enforcement rights on its own behalf (but subject to its obligation to act in accordance with any direction given to it by the Bank in respect of the shared mortgage).	Bank A will, in practice, have priority in respect of the exercise of all enforcement rights

4.5 Impact on risk-weights for retained assets which are unsecured

If a bank securitises assets which are secured debts of the bank (such as residential home loans) where the borrower also has an unsecured debt with the bank (such as a credit card or personal loan), the ASF notes that the trust back arrangements under consideration in this section are not relevant to, and should not impact, the risk weights to be applied with respect to those unsecured assets retained by the bank, irrespective of whether the bank may have obtained an all-moneys mortgage which may also cover those unsecured debts.

5. Other items

5.1 Liquidity treatment for Minimum Liquidity Holdings (MLH) ADIs

Proposed liquidity requirements for funding-only transactions for MLH ADIs is set out in Section 2.13.2 of the Discussion Paper. The ASF highlights that both funding-only and regulatory capital relief securitisations have no recourse to the originating ADI and any call features are structured with no legal requirement to call or redeem notes issued by the securitisation trust. On this basis, we request APRA reconsider the requirement that the liabilities of a funding-only transaction be included in liabilities when calculating regulatory liquidity for MLH ADIs. The ASF recommends that the liabilities of both funding-only and regulatory capital relief securitisations be excluded in the calculation of the MLH ratio unless the securitisation does not meet the requirements of Attachment A, paragraph 10 of the proposed APS 120.

5.2 Derivative transactions

In the context of derivative transactions conducted by an ADI, the ASF requests that the language in paragraph 6 of Attachment D of proposed APS 120 be amended to permit the subordination of break costs payable to the ADI in its role as swap provider where either:

(a) a default or termination event in respect of the ADI has occurred under the swap; or

(b) corresponding break costs have not been collected from the underlying debtor (e.g. the borrower under the exposure assigned to the SPV).

Such amounts should be permitted to be subordinated to all investor interests in a securitisation and they currently are in existing securitisation transactions.

The rationale behind the existing construct and on-going request is to preserve cashflow integrity of the securitisation vehicle. In most, if not all, existing securitisation transactions, an ADI is not permitted to be paid break costs at a senior level where the ADI is effectively at fault (e.g. a default or termination event applies to the ADI under the swap). Similarly, in rated securitisations, uncollected break costs are subordinated as the rating agencies will not permit such unquantified amounts to be senior ranking. The ASF welcomes the opportunity to discuss the implications of paragraph 6 of Attachment D. While it is clear that derivatives are fundamental in protecting investor interests (mitigating any interest rate or currency mismatches and movements), the proposed language would impede the ability of ADIs to provide derivatives to securitisations.

5.3 Treatment of self-securitisations

All the major banks and some regional bank ADIs that are Tier 1 participants in the Bulk Electronic Clearing System (**BECS**) are currently obtaining funding from the RBA using self-securitisation as collateral in the "open repo" operations. The face value of self-securitisations that are required to be lodged are determined by the RBA. Paragraph 36 of the proposed APS 120 and section 2.9 of the Discussion Paper propose "that an ADI that undertakes a self-securitisation must comply with funding-only requirements only from the point it uses the securities as collateral to obtain funding under a repurchase agreement from the RBA. Up to this point, an ADI has the flexibility to buy-back loans, redeem notes, sell additional loans into the pool, or terminate the arrangement."

ADIs which have established a self-securitisation have no intention to raise funding from external investors other than RBA either via the "open repo" operations or other open money market operations provided by RBA; there is no intention to sell the self-securitisation to other third party investors such as fund managers or other ADIs.

The ASF requests that APRA allow ADIs to manage assets in self-securitisations flexibly and to "buy-back loans, redeem or issue notes and sell additional loans into the pool" at all times as this is essential to continuous satisfaction of RBA eligibility criteria. If ADIs do not have his flexibility, it may require ADIs to establish two (or more) self-securitisation trusts which would be costly and operationally cumbersome as outlined below.

The flexibility is important in the following examples:

(a) the RBA precludes repo eligibility for self-securitisations if the notional value of a swap (such as a fixed or floating swap) exceeds 25% for loans with a fixed term of less than five years; or exceeds 1% for loans with a fixed term of greater than five years [16];

(b) borrowers with variable rate home loans generally have the option to switch to a fixed rate loan at any point during the term of their loan. This could trigger a breach of the swap threshold and deem the self-securitisation ineligible according to the RBA criteria[17], potentially causing an ADI to have insufficient liquid assets to satisfy its prudential liquidity requirements. In order to rebalance its portfolio, an ADI needs to retain the ability to repurchase fixed rate loans and replace them with variable rate loans to ensure the swap threshold is not exceeded. Where the threshold is exceeded, the RBA will deem the self-securitisation as ineligible collateral and the ADI may be in breach of APS 210. The repurchase of loans would not be permissible under paragraph 20 of the proposed APS 120 and paragraph 7 of Attachment A. If the proposed APS 120 is retained, and RBA doesn't change its eligibility criteria, ADIs may need to maintain two (or more) self-securitisations. The first self-securitisation would be lodged with the RBA under "open repo" and if it ceases to be eligible collateral by the RBA due to an increase in the proportion of fixed rate borrowers above 25% for example, an ADI would need to lodge the second self-securitisation to the RBA. Maintaining two self-securitisation trusts is expensive and operationally intensive as it would require ADIs to pay twice the rating agency costs, trustee, legal and Austraclear costs.

(c) ADIs need to maintain the ability and flexibility to increase or decrease the size of the self-securitisation annually to efficiently manage APS210 liquidity requirements. In the event the CLF allocated to an ADI is reduced, the ADI may reduce the size of the self-securitisation by repurchasing mortgages and reducing the size of the notes.

[16] RBA requirements "Intraday, Overnight and Open RBA Repos" http://www.rba.gov.au/mkt-operations/resources/tech-notes/standing-facilities.html RBA Margin Ratios http://www.rba.gov.au/mkt-operations/resources/tech-notes/margin-ratios.html

[17] Section 2.3 Interest rate swap provider - For a counterparty that provides an Australian dollar denominated interest rate (fixed-for-floating or floating-for-fixed) swap, an additional discount of 3 percentage points is applicable where:

- the notional swap principal is less than 25 per cent of the value of the collateral pool held by the issuing trust;
- the value of any assets with interest rates fixed for greater than 5 years does not exceed 1 per cent of the value of the collateral pool held by the trust; and
- the maturity of any fixed-rate debt issued by the trust does not exceed 5 years.

Where any of these conditions are not met, an interest rate swap provider will not be permitted to sell the security to the Reserve Bank.

Maintaining a larger than necessary self-securitisation is inefficient due to unnecessary encumbrance of assets and on-going external costs.

(d) ADIs may also increase the size of the self-securitisation if funding markets are dislocated or closed; and the ADI may need to raise additional funding from the RBA as was the case during the GFC.

(e) The rating agencies or the RBA may change their criteria for 'AAA' or repo eligibility respectively, which requires additional credit enhancement to be added to the self-securitisation or other restructuring that would not be permitted in a funding-only securitisation in order to maintain repo-eligibility and satisfy an ADI's liquidity obligations.

The ASF also requests that the proposed requirement for self-securitisations to be funding-only structures with a single junior tranche not be imposed on existing self-securitisation structures; and that grandfathering be permitted. The self-securitisation structures of most issuers were established post GFC and to restructure existing self-securitisations to have only a single junior tranche of securities would be expensive and reduce flexibility in ADI liquidity management.

5.4 Synthetic securitisations

The ASF supports the submission being submitted to APRA by the International Association of Credit Portfolio Managers.

Synthetic securitisations are an important tool for managing ADI balance sheet portfolio risk and transferring such risk to real money investors outside of the banking system. In particular, the ASF notes that:

(a) synthetic securitisations are not necessarily more complex or opaque than standard vanilla securitisations and welcomes the opportunity to discuss this further with APRA; and

(b) funded or collateralised synthetic securitisations eliminate any concern about the ADI protection buyer being exposed to counterparty credit risk.

The ASF requests APRA to reconsider the proposal on capital relief for balance sheet synthetic securitisations. Further consultation with industry to establish clear guidelines will ensure alignment with APRA's key principles of simplicity and transparency.

5.5 Definition of Originating ADI

The ASF understands that APRA's desire to retain 'managing ADI' within the 'originating ADI' definition relates to its concern around implicit support, such as in the case of purchasing securities. While the credit risk is retained by the originator of assets under funding-only deals, implicit support is particularly relevant for capital relief securitisations where this may undermine the achievement of significant risk transfer (and understate the credit risk that should be held by the originating ADI).

We note that a trust manager (or managing ADI):

- does not originate the assets;
- does not hold regulatory capital against the assets it manages;

- is not the beneficial owner of securitised assets post the initial sale, nor the beneficiary of the trust; and
- may be replaced at the trustee's and/or investors' express right.

As such, where the managing ADI is unrelated to the ADI who originated the assets (and is therefore not the sponsor of the securitisation), it would have no motivation to purchase securities to support trading activities in the event there was a need. Their role is simply limited to performing calculations and supporting the trustee to perform certain duties.

The ASF highlights certain provisions in the proposed APS 120 that are not relevant to the managing ADI where the managing ADI is unrelated to the originator and sponsor of the securitisation:

(a) while paragraphs 18-23 of the proposed APS 120 have been taken from the current APS 120 Attachment B, this relates to where the originating ADI is seeking regulatory capital relief. Given the managing ADI is not capable of seeking capital relief, these paragraphs in the current APS 120 are not relevant to the managing ADI.

More specifically, the following paragraphs under the proposed APS 120 are of concern:

- paragraph 18: prior to securitisation, the managing ADI does not control the assets, hold credit risk nor does the managing ADI make any representations and warranties regarding the assets subject to the securitisation. Therefore it is not possible for the managing ADI to retain this risk;
- paragraph 20: the managing ADI does not control the assets and therefore is not able to alter the composition of the securitisation asset pool. Further the managing ADI does not hold the first loss position in the securitisation hence has no ability provide additional credit enhancement;
- paragraph 21: the managing ADI does not provide any representations and warranties relating to the exposures sold into the SPV where it is not the owner or originator of the assets;
- paragraph 22: the managing ADI has no ability to reschedule or renegotiate any securitised exposure. This is the role of the originator and servicer for the assets and therefore the managing ADI should not be required to ensure this is reflected within the securitisation;
- paragraph 23: as the managing ADI does not own the assets being securitised, it is not able to obtain a 'true sale' legal opinion;

(b) paragraphs 27-29: these relate to the situation where the originating ADI may receive potential benefits from the securitisation. As with any other service provider, the managing ADI does not recognise income until it is received, therefore these paragraphs would not be applicable;

(c) paragraph 30: the managing ADI is not able to claim capital relief under this paragraph as it holds no credit risk for the assets pre-securitisation;

(d) paragraphs 32-36 require the originating ADI to comply with the operational requirements of Attachment B. These paragraphs are not applicable to the managing ADI given that:

- it does not hold regulatory capital against assets it manages;
- credit risk for any facilities provided to the SPV is captured under paragraph 38 of the proposed APS 120;
- it does not control any collateral of a securitisation, including a self-securitisation;

(e) paragraph 37 relates to the credit risk of the originating ADI with respect to synthetic securitisations. As noted above, the managing ADI does not hold regulatory capital pre-securitisation and therefore this paragraph is not relevant;

(f) Attachment A requires the originator to satisfy certain conditions to achieve regulatory capital relief. The managing ADI would not be seeking capital relief and therefore this attachment would not be applicable;

(g) Attachment B relates to the operational requirements for funding-only deals. This attachment relates to any potential implicit support the originator may provide. For the reasons noted above, we consider this attachment is not applicable for the managing ADI.

We consider that the concerns APRA may have in relation to the managing ADI providing implicit support are addressed under Attachment D paragraphs 1 and 7-10 of the proposed APS 120. This includes services being:

(a) conducted on an arm's-length basis;

(b) provided in accordance with normal market practice, including the "ADI has no liability with regard to the performance of the pool";

(c) limited to remitting funds as and when they are received;

(d) provided with representations and warranties on the part of the managing ADI such as not to constitute implicit support, including the "future creditworthiness of the exposures, the performance of the SPV or the securities issued in a securitisation"; and

(e) terminated at the election of the trustee and/or investors.

In addition to the paragraphs noted above, the proposed APS 120 includes other paragraphs that potentially give rise to implicit support concerns for the managing ADI, being paragraphs 15(a), 15(c), 15(f) and paragraphs 16 and 17. For these provisions, the managing ADI would be in a position to confirm its involvement, and therefore it does not give rise to a cause for concern.

For the reasons above and in order to ensure there is no misinterpretation of the standard, the ASF recommends APRA exclude 'managing ADI' from the 'originating ADI' definition and include 'managing ADI' explicitly in relevant provisions of the standard as outlined in this paper.

The ASF also seeks clarification under paragraph 35 of the proposed APS 120[18]. The wording currently appears only to capture the originating ADI providing the ABCP conduit. We believe that the intention of this paragraph is to capture any implicit support concerns relating to ADIs which are funding via the ABCP market in addition to the sponsor of the conduit. The ASF therefore suggests replacing "originating ADI" with the words "originating ADI funded by, or a managing ADI" in this paragraph 35.

5.6 ABCP

The Discussion Paper requires the following capital provisions for a pool of ADI originated receivables funded through an ABCP program:

(a) the ADI **originating** the receivable is required to hold capital against the pool of receivables;

(b) the ADI providing **support** facilities is required to hold capital against the pool of receivables;

(c) the ADI providing support facilities is also required to hold capital against the facilities provided including full **CET1 deductions** for:

  (i) non-senior securitisation exposures (credit enhancement facilities and fully/partially supported liquidity facilities); and

  (ii) resecuritisation exposures.

As seen above, for an ADI originated pool of receivables, the capital allocated to support funding through an ABCP conduit represents many multiples of that required for a self-funded portfolio. This makes ABCP funding inefficient under the proposed APS 120.

The ASF understands that originating ADIs will not achieve capital relief though ABCP funding (given the short-dated nature of the ABCP), and therefore it is appropriate for the originating ADIs to hold capital against this pool of receivables. However, we recommend adopting the Basel III Framework, which does not require ADIs providing support facilities to hold capital against the pool of receivables, but rather, capital is allocated against the facilities (exposures) provided to the ABCP program.

5.7 Classification of RMBS and other ABS as a Level 2 Liquid Assets

In section 2.3 of the Discussion Paper, APRA states that in allowing for more flexible securitisation structures its desire is to reduce reliance by ADIs upon the CLF.

The changes outlined in the proposed APS 120 are considered positive for the securitisation market in Australia. However, in order to fully support an efficient securitisation market in Australia, and reduce the reliance by ADIs on the CLF, the ASF maintains that RMBS and other ABS should be included as level 2B liquid assets. We propose the following minimum criteria for eligibility to be included as liquid assets: (i) AAA rated; and (ii) satisfies the RBA eligible security requirements (including reporting requirements).

[18] Paragraph 35 of the proposed APS 120 reads "An originating ADI of an ABCP securitisation must treat the securitisation as a funding-only securitisation and comply with the operational requirements for funding-only securitisation (refer to Attachment B)".

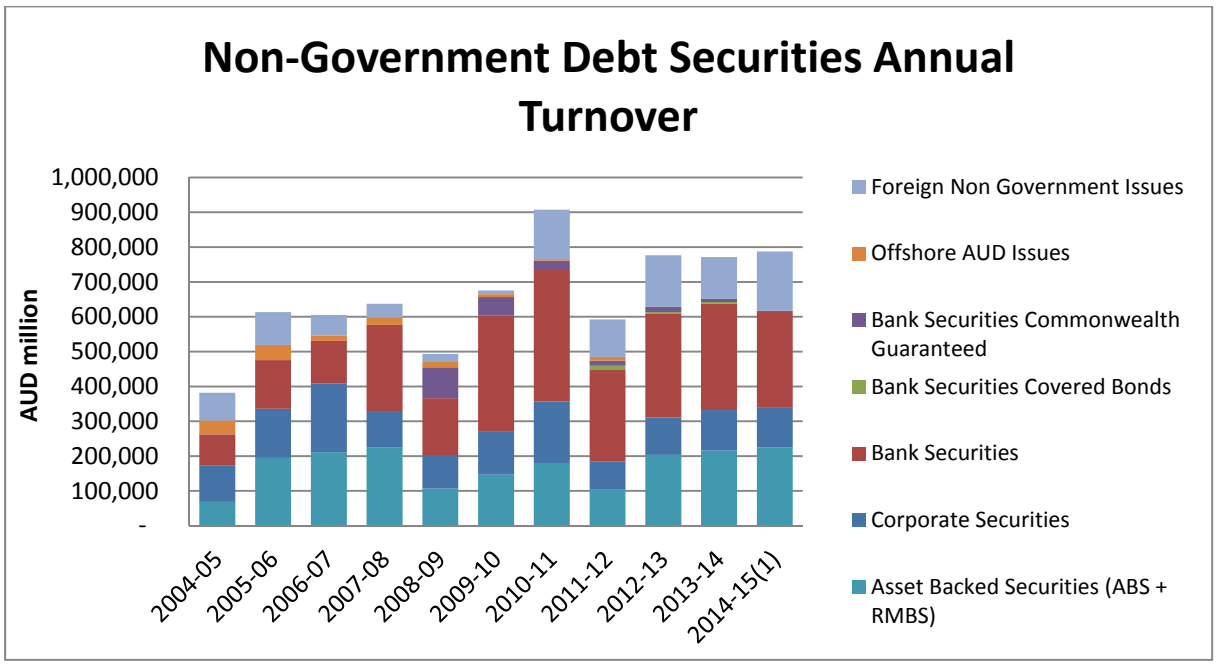
The introduction of the current Liquidity Coverage Ratio framework has seen investor appetite (other than major banks) for RMBS and other ABS reduce in favour of other liquid assets due to (i) Australian ADIs being unable to recognise these as HQLA; and (ii) foreign bank branches being unable to consider Australian RMBS and other ABS as liquid assets as they cannot access the CLF. The effect of this is that overall demand for, and liquidity of, asset-backed securities has reduced. As a result, the ability of Australian ADIs to increase securitisation funding is currently being constrained, thereby reducing access to diverse sources of funding, increasing funding costs and reducing competitiveness of ADIs.

Classification of AAA rated RMBS and other ABS as liquid assets is supported for the following reasons:

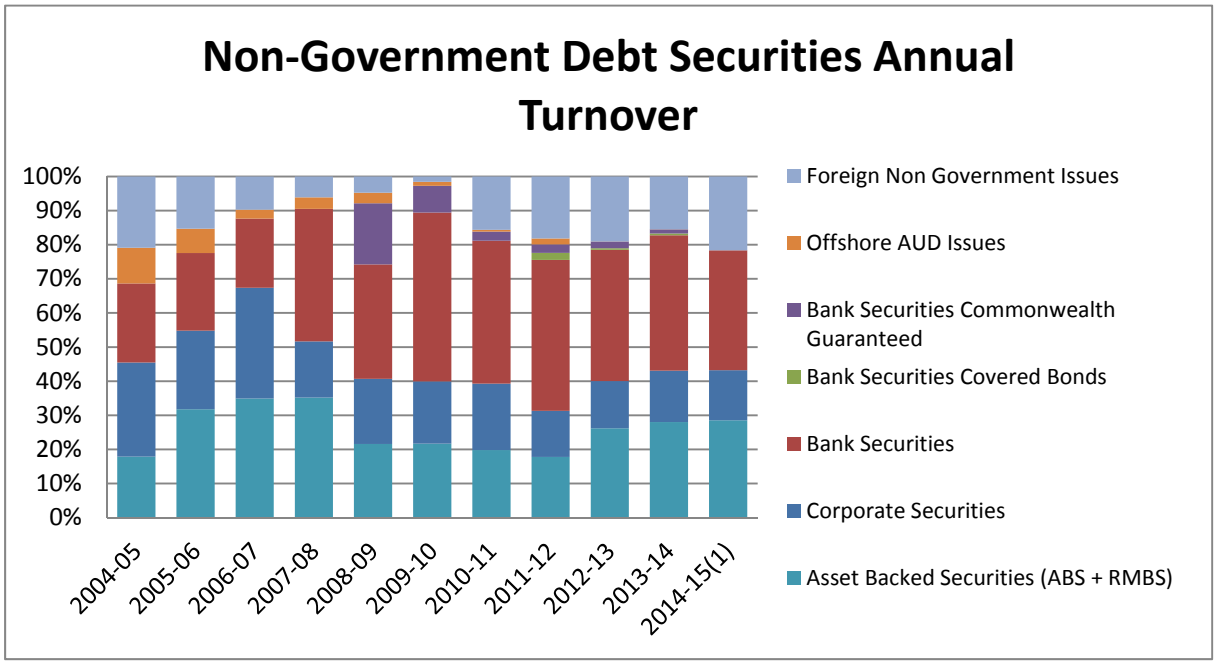
- RMBS and other ABS are high quality assets that have performed well, even during times of market disruption (as outlined further below);
- the liquidity of Australian RMBS and other ABS was demonstrated by its continued active trading during the GFC as investors remained confident in the quality of the underlying assets. This was highlighted in the speech by Guy Debelle Assistant Governor (Financial Markets) of the Reserve Bank Of Australia (RBA) on 30 November 2010 (http://www.rba.gov.au/speeches/2010/sp-ag-301110.html), where in particular it is noted that Australian RMBS were often sold first by SIVs due to their good performance;
- these assets are repo-eligible with the RBA for normal market operations and are eligible collateral for the CLF from the RBA. As such, they provide a reliable source of funding during stressed market conditions;
- although they can't treat them as outright HQLA, larger Australian banks with access to the CLF are able to use RMBS and other ABS as eligible collateral towards meeting the Liquidity Coverage Ratio. Banks without access to the CLF cannot use these assets to meet their liquidity requirements. Permitting RMBS and other ABS as HQLA would level the playing field between the larger and smaller banks;
- greater international alignment of Australia's liquidity standards with other jurisdictions, particularly Europe and the UK;
- the extra risks (liquidity, market, concentration) when allowing RMBS and other ABS as HQLA would be mitigated by the following:
    - Haircuts – Level 2B assets are subject to significant haircuts (25-50%); and
    - Concentration limits - Level 2B assets are limited to 15% of the total stock of HQLA.

In a similar way, although not directly related to the proposed APS 120, we consider that AAA rated covered bonds should also be considered level 2 liquid assets.

In support of the above submission, the charts below show the liquidity and performance of ABS in times of market disruption and in particular show Non-Government Debt Securities annual turnover for the 10 years to 2014 based on the Australian Financial Markets Report from AFMA.



Source: AFMA



Source: AFMA

Footnote: (1) From 2014-15 year: (a) "Asset Backed Securities" also includes Covered Bonds; and (b) Corporate Securities include Offshore AUD Issues.

The main observations from the charts above are:

- ABS accounted for between 18-35% of annual turnover volumes in the Non-Government Debt sector over the 10 year period;
- ABS turnover is second only to bank securities (i.e. senior unsecured issues);

- even during market disruptions of 2007-2009, ABS accounted for 20-30% of Non-Government Debt Securities annual turnover; and
- ABS instruments are high quality assets that have performed well, even during times of market disruption.

5.8 Clean-up calls and revolving structures

The ASF requests clarification as to the operation of clean-up calls in the context of revolving structures. Would it be acceptable for the call to be structured so that it can be exercised once the assets amortise down to 10% or less of the maximum value of the assets in that securitisation with a revolving structure at any previous point in time.

5.9 Miscellaneous other items

5.9.1 Prudential Practice Guidance (**PPG**): We note that APRA will be issuing a draft PPG for consultation in the first half of 2016. The ASF notes that the PPG has been a useful interpretative tool and contains clarification in relation to a number of provisions in the proposed APS 120 (which have been carried over from the current APS 120). To the extent that those clarifications continue to be relevant and continue to form part of APS 120, the ASF considers that those provisions should form part of the revised PPG.

5.9.2 Definition of “SPV” & “traditional securitisation”: These definitions should also contemplate structures where the assets are originated in the name of the SPV as opposed to being acquired from a seller.

5.9.3 Paragraph 19: The words "other than restrictions necessary for compliance with legal requirements" which qualify the equivalent requirement in the current APS 120 need to be incorporated here (refer to Attachment B, paragraph 2(c) of the current APS 120).

5.9.4 Paragraph 19: the second sentence should also contemplate claims against the ADI permitted by APS 120 e.g. under representations and warranties that comply with Attachment D.

5.9.5 Paragraph 20(c): Would APRA confirm that this paragraph does not limit the SPV paying an increased yield in the circumstances described, as opposed to the ADI.

5.9.6 Paragraph 76: should the prior notification requirement only apply to an interest in an ADI's Australian assets?

5.9.7 Paragraph 11(b), Attachment A: The ASF notes that an ADI may have exposure through facilities and services it provides to an SPV in compliance with APS 120. These should be contemplated in this paragraph.

Annex 1 – ASF submission to the BCBS on STC securitisations

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5 February 2015

Secretariat of the Basel Committee on Banking Supervision
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Dear Sir/Madam

Capital treatment for simple, transparent and comparable securitisations

The Australian Securitisation Forum (ASF) appreciates the opportunity to provide comments on the above BCBS consultative document released in November 2015.

ASF is the peak industry body representing the Australian securitisation and covered bonds markets. The ASF goals are to facilitate the formation of industry positions on policy and market matters, represent the Australian industry to local and global policymakers and regulators and to advance the professional standards of the industry through a comprehensive suite of educational courses and workshops. This submission is made by the ASF through its Regulatory and Prudential subcommittee.

The ASF supports the principles of designating of certain securitisations as being simple, transparent and comparable (STC) in the context of preferential regulatory capital treatment being applied to such transactions. We are currently in the process of responding to a second Discussion Paper and draft prudential standard on securitisation issued in November 2015 by the Australian Prudential Regulation Authority (APRA). APRA noted in its Discussion Paper the BCBS's consultative document and indicated its intention to address STC once the Basel Committee has finalised its proposals.

In summary, ASF believes that

- in addition to obtaining preferential capital treatment, securitisations that satisfy the STC criteria as applied by local regulators should also be eligible as:
    i. HQLA for the purposes of the LCR; and,
    ii. collateral in central banks cash liquidity operations.
- Basel should continuously have regard to the G20/FSB mandates to facilitate cross-border capital flows by focussing on harmonised STC product criteria and simple STC regulations across jurisdictions, reflecting the diverse nature of global debt capital markets and the respective real economies of the world that they serve.

Furthermore, we propose that qualification for, and the benefits of, STC should not be limited to certain jurisdictions, such as European Issuers. These limitations might arise directly (for example, by stating that the underlying assets must be domiciled in Europe) and indirectly (for example, by making the criteria too restrictive thereby excluding issuers from other jurisdictions whose conventional products could never comply[1]). Accordingly, we request that any STC regime implemented for Australian securitisations be recognised as equivalent by other jurisdictions' regulators with an STC regime, and therefore be granted the same capital, liquidity and repo-eligibility benefits as a STC-compliant European issued securitisation transaction in other jurisdictions. The initiative to support securitisations through an STC approach will be most successful if it is not restricted by jurisdictional anomalies.

Our submission is structured in two parts. The first provides some comments on the questions posed in the BCBS Consultative Document. The second section comments on issues raised by the STC criteria for Australian securitisations.

Yours sincerely

Chris Dalton

CHIEF EXECUTIVE OFFICER

[1] A number of examples where making the criteria too restrictive would inadvertently exclude issuers from other jurisdictions are set out in Section 2 of this document.

SECTION 1

Question 1: Do respondents agree with the rationale for introducing STC criteria into the capital framework? Are there any other aspects that the Committee should consider before introducing STC criteria into the capital framework that are not already reflected in the rationale above?

The ASF supports the introduction of STC criteria into the capital framework. We support the general principle that regulatory capital should be calibrated to the risk of the exposure. Securitisations can vary in nature from simple and established securitisations to newer, esoteric or more complex securitisations.

Question 2: Do respondents agree that, for the purpose of alternative capital treatment, additional criteria are required? What are respondents' views regarding the additional criteria presented in Annex 1?

The additional criteria proposed to address the credit risk, granularity and relationship between the originator and servicer of the pool are relevant aspects of a securitisation to consider when determining regulatory capital for the transaction. Section 2 provides the ASF's views on the additional criteria outlined in the consultative document.

Question 3: What are respondents' views on the compliance mechanism and the supervision of compliance presented in this consultative document?

The ASF believes the compliance mechanism should be determined by local regulators as part of the implementation of a STC regime. The ASF notes that whilst STC criteria contain a degree of subjectivity, self-certification should not be problematic because transparency and market discipline (chiefly in the form of the on-going desire of sponsors to maintain their reputation and therefore future issuance capacity). However, where a local regulator deems self-certification unacceptable, ASF is not in supportive of third-party arbitrators being engaged to opine on whether or not a transaction meets STC criteria.

See our remarks in Section 2 in relation to cross-border mutual recognition/equivalence.

Question 4: What are respondents' views on the alternative capital requirements for STC securitisation presented in this consultative document?

In general, the ASF supports the lowering of the risk-weight floor for senior exposures in STC securitisations. We also note that some Australian securitisations are structured so that the senior exposure is tranched with the mezzanine tranche still being able to achieve a rating of 'AAA'. We

suggest the risk-weighting of mezzanine tranches should also be reduced commensurately with the reduction applied to the most senior exposure.

We support the adjustment to the non-neutrality framework to achieve an outcome where less risky underlying assets can benefit from lower capital charges.

We again support the principle that the risk weights in the relevant table for the rating-based approach (SEC-ERBA) should be reduced for STC securitisations.

SECTION 2

General

It is not clear from the Consultative Document whether a securitisation can move in and out of STC designation over time. Some of the criteria may lead to transactions complying some times and not at other times leading to capital volatility. It would be helpful for the approach in such circumstances to be clarified.

Role of supervisors in the determination of STC compliance

To ensure a level playing field for all securitisation players, we strongly support a regime where bank and non-bank lenders are able to benefit from the STC regime. As such, the regulatory body should extend to the regulatory body assigning a credit licence to a sponsor of a securitisation in Australia, (i.e. any entity with an ASIC credit licence should be able to satisfy STC criteria).

A. ASSET RISK

As an overarching comment, below are a number of examples whereby the criteria is too restrictive or too aligned to the European market, therefore inadvertently excluding a number of non-European Issuers from complying with STC, despite clearly meeting the principles STC set out to achieve. In a number of the ASF's responses below, we have stipulated that the criteria should be based on the local jurisdiction's requirements to comply with STC, and that compliance should afford any issuer with the same benefits as a European Issuer.

<u>A1 Nature of assets</u>

Homogeneity

We note that the example of auto loans reflects a typical US auto loan transaction and not a typical Australian auto loan transaction.

In Australia the following would be considered as part of a homogeneous pool:

- Retail assets may not amortise to zero but have a balloon payment at the maturity date of the loan
- Retail assets may be mixed with commercial assets (corporate/floorplan/dealer assets)
- Finance leases including novated leases (but not operating leases) could be included with loans
- Equipment is often mixed with auto assets in commercial pools

Any consideration of homogeneity should take into account typical pools in the Australian market.

Given the scope of the market and the number of jurisdictions the proposed framework spans, this criterion appears to prescriptive and we recommend this too be more principles-based.

Commonly encountered market interest rates

We query if this is referring to interest rates on the assets or the liabilities of the securitisations? If assets, then most Australian securitisations of residential mortgages (i.e. RMBS) are based on mortgage rates set at the discretion of the lender so we query whether this satisfies the "*commonly encountered market interest rates*" requirement.

A2 Asset Performance History

The Consultative Document notes that performance history should cover at least seven years for non-retail exposures. Consideration should be given to the nature of the assets and their underlying term. For example, corporate receivables with a maturity of 30 days will revolve many times within seven years. This will also stifle new entrants.

We highlight the practical constraints in providing the amount of data over a 7-year time series to investors will create a high barrier to entry. Also we suggest guidance is provided on a sufficient implementation period.

A3 Payment Status

"*receivables … may not, at the time of inclusion in the pool, include obligations that are in default or delinquent…*"

This will cause securitisations of acquisitions of portfolios to be excluded from being classified as STC as they will typically have some level of delinquency which is no different to a STC pool after a few years once delinquencies have arisen.

This will also exclude master trusts from STC as at the time of issue of a series of notes there will almost certainly be delinquencies in the ongoing pool. In Australia, typical securitisations of non-conforming mortgages include some loans in arrears.

Exclusion of credit impaired borrowers will exclude some non-conforming portfolios from being considered STC.

The requirement for at least one payment to have been made will exclude warehouses that settle receivables from being considered STC.

A5 Asset Selection and Transfer

"*Investors should be able to assess the credit risk of the asset pool prior to their investment decisions…*"

This may cause an issue for master trusts (and other revolving securitisations) as investors in earlier series will be exposed to assets subsequently added without getting a chance to assess them beforehand. We note that the accompanying paragraph contemplates eligibility criteria and is mainly focused on ruling out active management in an STC securitisation which we support. Clarification should be provided that the requirement for investors to be able to assess the credit risk prior to investment wouldn't apply to subsequent mortgages added to master trust structures.

A6 Initial and ongoing data

STC requires the initial portfolio to be reviewed by an independent third party. While issuers typically have a compliance framework in place to verify data provided to investors, this may be internally based. The cost of an external review is significant and would increase the transaction costs for each issue, in addition to the data compliance requirements imposed onto the issue. Further, it is noted that auditors will not allow results to be published in external documents without their consent as outlined in footnote 20 of the BCBS STC Document.

B. STRUCTURAL RISK

B8 (currency and interest rate asset and liability mismatches)

We believe there is a potential concern that in an Australian context total return swaps provided to many ADI RMBS deals could cause Australian issuers problems in the STC framework. It would be very difficult to provide sensitivity analysis requested by the discussion paper for total return swaps given the inability to mark-to-market (MtM) these derivatives. We therefore request guidance on

what sensitivity analysis is required to be performed. For example, will BCBS provide criteria for different types of swaps?

B12 (alignment of interest)

APRA has indicated there is unlikely to be skin in the game in an Australian context which would therefore make it impossible for Australian deals to meet this requirement. BCBS should respect the local regulator's position on skin in the game when imposing this criterion in the STC framework.

B9 Payment priorities and observability

"*Failure to acquire sufficient new underlying exposures of similar credit quality*" is listed as a required amortisation event which would not be typical for an Australian securitisation warehouse or master trust and should be removed or qualified by whether it is typical in the jurisdiction.

B11 Document disclosure and legal review

"*Terms of the documentation of the securitisation should be reviewed by an appropriately experienced third party legal practice, such as a legal counsel already instructed by one of the transaction parties e.g. by the arranger or the trustee.*"

We suggest this should be clarified as to what the intent is. It is not clear to us what the review should cover and from whose perspective. Each legal counsel in a transaction will review some or all of the documents from the perspective of who they are representing.

B12 Alignment of interest

"*…the originator or sponsor for the credit claims or receivables should retain a material net economic exposure…*"

This should be dependent on each jurisdiction's own credit risk retention requirements. We are not in favour of STC creating an additional skin in the game requirement.

D. Additional criteria for capital purposes

We support BCBS's approach to revisit the parameters in criterion D15 once the ongoing revisions to the Standardised Approach to credit risk are finalised. We support the intent of criterion D16 to limit the concentration to individual obligors in a securitisation. Further it is recognised that the level of obligor concentration may vary between different asset classes. However, we suggest an approach based on effective number of exposures be adopted instead.

With respect to D17, we suggest that there be consideration given to circumstances where a regulated entity may not be the originator of a pool of assets but rather may now be the legal owner and servicer of the assets as a result of an acquisition of the organisation that originated the assets or an acquisition of the assets. Since the financial crisis a number of financial institutions have acquired other institutions and/or portfolios in Australia and the fact that the new owner was not the originator of the assets should not automatically disqualify asset pools from being eligible for preferential capital treatment as a STC securitisation.

D15 credit risk of underlying exposures

Standardised risk weight limits will preclude certain asset classes in Australia from STC (e.g. retail auto loans, non-conforming mortgages, and commercial mortgages). The limits will need to reflect the particular risk weights in a jurisdiction.

D16 Granularity of the pool

Limit of 1% may impact some securitisations. We suggest an approach based on number of *Effective Exposures* instead.