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Ms Heidi Richards
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By email: ADIpolicy@apra.gov.au

Dear Heidi

Thank you for taking the time to meet with members of the ASF's Regulatory and Prudential subcommittee on 10 October 2017. We also thank Paul Veerhuis, Paul Riley, Gavin Maunder and Antony Pham for their time and helpful explanations.

As agreed at our meeting, the ASF would like to provide commentary for consideration by APRA when framing PPG 221 with a view to seeking clarity around the proposed risk-based treatment of securitisation exposures under the new *APS 221 – Large Exposures (APS 221)*.

1. Securitisation exposures

As a general proposition, the ASF is of the view that securitisation SPVs should not normally be assessed as a “connected counterparty” of the originator or sponsor of the SPV (“**third party**”), and therefore exposures to the SPVs should not normally be aggregated with exposures to the third party in assessing the large exposure limits of APS 221. Aggregation should only be required where a risk-based assessment undertaken by the ADI reveals causal linkages

between default risk of the originator/sponsor on the one hand, and the SPVs and/or their assets on the other hand, as contemplated by the final draft standard¹.

The underlying assets of the securitisation may be originated by an ADI or a non-ADI. Originated assets (e.g. residential home loans) are assigned to a bankruptcy remote SPV, typically a Trust with an independent trustee company.

Securitisations are usually structured to ensure that an insolvency of the originator, sponsor or other service provider does not trigger an insolvency of the securitisation structure (i.e. they are “**bankruptcy remote**”). The bankruptcy remote nature of securitisation SPVs constitutes a legal framework that requires separation between the originator, sponsor or manager on the one hand and the trustee and security trustee which holds the securitised assets for the benefit of investors.

2. APS 120

Where the originator of, or investor in, the securitisation is an ADI, the securitisation must comply with ADI Prudential Standard *APS 120 – Securitisation (APS 120)*. Under paragraph 15 of new APS 120 (January 2018), an ADI must be independent of the SPV including the requirements that an originating ADI must not:

- own or hold any material interest in the trustee company;
- be liable for the obligations and liabilities of the SPV, particularly in the event the SPV incurs losses.

The services provided by the ADI to the SPV such as servicing of assets, arrears management and provision of liquidity facilities, must be provided by the ADI on an at arm’s length basis and on market terms and must not provide, or knowingly create or encourage a perception that it will provide implicit support for a securitisation (paragraph 13 of APS 120 (January 2018)).

An originating ADI must not maintain effective or indirect control over exposures transferred to an SPV in accordance with paragraph 18 of APS 120 (January 2018). In an event of an ADI insolvency, the legal title of the assets will formally transfer from the ADI to the independent trustee and the trustee will act in accordance with the transaction documents, with a fiduciary duty to the securitisation investors.

To the extent a third party performs services or provides facilities, such as swaps and liquidity facilities, securitisation documentation usually contains specific provisions that in the event of an insolvency of such party, investors will have an express right to replace the defaulting party as a service or facility provider thereby ensuring the securitisation’s payment obligations

¹ Refer paragraph 29 of Attachment A, and footnote 17, of draft APS 221

continue to be met (subject to the performance of the securitised assets), in compliance with Attachment D to APS 120 (January 2018).

3. Risk-based assessment

In addition to the above, it is the ASF's view that:

1. RMBS/ABS backed by assets originated by a non-ADI and assigned to a bankruptcy remote SPV with an independent trustee should not be automatically aggregated to the originating non-ADI where a non-ADI provides services or facilities that are structured on terms consistent with normal securitisation principles.

That aggregation should not automatically take place in the normal course is consistent with the fact that the insolvency of the originator does not trigger an event of default for RMBS/ABS notes issued by securitisations originated by that entity. Securitisation investors have no claim on the assets of the originator in the event of an originator insolvency, and additionally, the originator has no claim on the assets assigned to the SPV.

2. Where an exposure is classified as a securitisation exposure for regulatory capital purposes, aggregation to the originator or a sponsor (even as service or facility provider) for APS 221 purposes would not be appropriate, unless the ADI determines that one or more additional risk factors exist where it would be appropriate to aggregate the securitisation exposure with its exposure to the originator and/or sponsor. This assessment would be despite the bankruptcy remoteness and legal separation of the securitisation and whether independence requirements of APS 120 are met; i.e. we would expect that aggregation of SPV and originator/sponsor/other facility provider would be on an exceptions basis. The test to determine whether a securitisation exposure ought to be aggregated to the ADI must be risk-based and undertaken as a part of the ADI's own internal credit assessment of the exposures and any supporting facilities.

4. Covered Bonds

With respect to covered bonds, while the exposure to the ADI should be recognised in the large exposure treatment under APS 221 (as the ADI is the Issuer of the Covered Bonds) it is unclear to us why APRA has chosen to diverge from international standards by requiring recognition of the full nominal value, rather than the Basel 20% concessionary treatment. Asset backed securities, including securitisations and covered bonds, are specifically excluded from international bail in regimes such as TLAC. The risk of contagion, being a key intention of the large exposure proposals, is therefore already reduced.

In line with Basel, it is important that the Australian large exposure treatment recognises these particular features of covered bonds, including that they are dual recourse in nature, where certain criteria are met. Covered bonds are an important source of funding for Australian ADIs and it is important that the large exposure framework does not have unintended

consequences on the Australian market and create a competitive disadvantage compared to international peers.

The ASF would welcome the opportunity to have further dialogue with APRA particularly in relation to PPG 221 (when released in early 2018). In the meantime, if you have any questions in relation to any of the matters raised in this letter please let us know.

Yours sincerely

A handwritten signature in black ink that reads "Chris Dalton". The signature is written in a cursive style with a large, prominent "C" at the beginning.

Chris Dalton