CUSTOMER OWNED BANKING ASSOCIATION

www.customerownedbanking.asn.au

LEVEL 11, 35 CLARENCE STREET, SYDNEY NSW 2000 GPO BOX 4686, SYDNEY NSW 2001

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Mr Neil Grummitt
General Manager, Policy Development
Policy, Statistics and International Division
Australian Prudential Regulation Authority
GPO Box 9836
SYDNEY NSW 2001

By email: APS120review@apra.gov.au

Dear Neil

Securitisation Discussion Paper

Thank you for the opportunity to comment on APRA's April 2014 Discussion Paper *Simplifying the prudential approach to securitisation*.

As you know, COBA is the industry association for Australia's customer-owned banking institutions, representing 82 credit unions, 11 mutual banks and 6 mutual building societies.

COBA welcomes APRA's view that it "would like to see a large and liquid securitisation market supporting competition in Australian home lending."[1]

Securitisation provides an important source of funding and a means of funding diversification for smaller ADIs. In addition, by allowing unrated or lower-rated lenders to issue highly rated debt, a well-functioning securitisation market helps support banking competition. As noted by a recent Senate Inquiry:

> "Prior to the global financial crisis securitisation played a key role in supplying funds for smaller lenders. It therefore helped enable stronger competition in the sector."[2]

As noted in the Financial System Inquiry's Interim Report:

> "Before the GFC, short-term debt and securitisation provided a cost-effective form of funding that allowed smaller ADIs and non-bank lenders to compete with the major banks."[3]

And:

[1] Littrell, *Prudential Reform in Securitisation,* 11 November 2013, p. 5.
[2] Senate Economics References Committee, *The post-GFC banking sector,* November 2012, pp. xxi-xxii.
[3] Financial System Inquiry, *Interim Report,* July 2014, p2-13.

> "Funding is critical to ADI and non-bank lenders' ability to compete. The use of residential mortgage-backed securities (RMBS) was a key factor in growing the market shares of smaller banks and non-bank lenders before the GFC."[4]

We support APRA's review of the securitisation standard, as this work will form an important part of building a stronger securitisation market in Australia. COBA supports many of the proposals put forward in APRA's Discussion Paper, and in particular the explicit recognition of funding-only securitisations and the adoption of date-based calls for funding-only securitisations.

As a general comment, COBA reiterates the importance of prudential standards being principles based. As APRA has previously noted, its supervisory approach "allows institutions to use a variety of approaches to comply with high-level principles, rather than APRA seeking to direct an institution through detailed prescription."[5] APRA has also acknowledged that the overly prescriptive approach currently in place under APS 120 is creating its own challenges. As noted last year by APRA's Head of Policy, Charles Littrell, "There was … the concern that whatever rule APRA put in place, the industry sometimes sought corner solutions, which might technically comply with the letter, but not necessarily the spirit, of the relevant standard."[6]

COBA believes that the current review of the Securitisation Prudential Standard presents APRA with an opportunity to streamline and simplify some of the current prescriptive obligations in APS 120.

While we are generally supportive of this review, we do have concerns about some elements of the discussion paper, and in particular proposals which we are concerned could negatively impact on competition and diversity in the banking sector. COBA highlights the following issues:

Warehousing

APRA's Discussion Paper says that under the current Securitisation Standard "APRA grants a concessional treatment for warehouse providers in allowing them to risk-weight the exposure to the warehouse under APRA's securitisation framework, even though the securitisation has not been placed in the market,"[7] and that "APRA has been willing to grant this concession on the basis that warehouse arrangements are temporary."

However, the Discussion Paper is proposing tightening the current arrangements, noting that "Although a warehouse has benefits as an aggregation model, APRA has concerns with its use as anything other than a temporary arrangement. Accordingly, APRA is proposing to limit the concessional capital treatment to warehouse arrangements up to one year."

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[4] FSI Interim Report – p1-13
[5] APRA, *Corporate Brochure – Protecting Australia's depositors, insurance policyholders and superannuation fund members.*
[6] Littrell, *Prudential Reform in Securitisation,* 2013, p. 3.
[7] APRA, *Discussion Paper – Simplifying the prudential approach to securitisation,* April 2014, p. 24.

This change is a significant concern for COBA members, as a change of this kind would make the use of securitisation very difficult for all but our largest members. The fixed costs associated with securitisation and investor desire for deals with a spread of investors mean that a minimum issue size is required to make securitisation feasible and economic. For smaller ADIs, challenges around minimum issue size can be overcome by writing the business over a longer period of time. APRA's proposed one year cut-off would be a significant impediment for our sector, with most members unable to generate sufficient business within a twelve month period to make the use of securitisation economic.

Obviously, this problem does not arise for larger ADIs such as the major banks. As such, we are concerned about the impact this change would have on both competition and diversity in the banking sector. From a financial stability perspective, we also note that funding diversification for smaller ADIs will be reduced by effectively cutting them out of securitisation.

COBA understands that APRA's concern is that the current arrangements can result in "lower capital being held in the banking system against the credit risk on residential mortgages."

However, the extent of this alleged problem is far from clear.

More significantly, the problem does not even arise where an ADI uses securitisation for funding-only purposes. In these cases, capital is already held against the loans as though they were on the ADI's balance sheet. As such, there is no capital leakage under a funding only approach. Further to this point, there is *more* capital in the banking system under funding-only securitisation to the extent that the warehouse provider is holding capital against the same underlying assets.

Even in securitisations where the originator is obtaining capital relief, the suggestion of "sustained capital leakage" is not convincing. There is no strong case made in the Discussion Paper for an arbitrary and prescriptive requirement that would have negative impacts on smaller ADIs and warehouse providers.

The 12 month limit would be difficult to impose in a practical sense and runs contrary to the principles-based approach.

COBA's view is that imposing a blanket twelve month restriction on all warehousing arrangements is overly restrictive and unnecessary. At a minimum, warehousing arrangements where there is no "capital leakage" (which would include all funding only securitisations) should be excluded from this proposal.

Multi-seller structures

One way that some of the barriers of scale can be overcome is through aggregation between customer-owned ADIs. In the case of securitisation, this can be achieved through the use of multi-seller structures by smaller ADIs.

The Discussion Paper notes APRA's concern that under current arrangements, "Imposing a credit risk retention requirement on such programs may expose an ADI to losses attributable to assets originated by other ADIs or other entities."

As APRA has previously noted "To make multi-seller structures work, the skin in the game requirements either become very complex, or they no longer bind on individual originators. APRA is open for suggestions on how we might solve this conundrum, but in the absence of a solution, the new APS 120 is unlikely to accommodate multi-seller structures."[8]

While we recognise that APRA has some concerns regarding the practical operation of multi-seller structures, we believe that explicitly excluding their use would be an overly restrictive response. We believe that the Prudential Standard should take a principles-based approach to the issue of multi seller structures which allows for their use subject to appropriate requirements being met.

Funding only securitisation

COBA welcomes APRA's proposal to explicitly recognise funding-only securitisation in the prudential standard. This will help to simplify arrangements for issuers who use securitisation to broaden and diversify their funding base. As part of this simplification, we support APRA's proposal to no longer require an ADI "to notify or seek APRA approval for a funding-only securitisation that meets all relevant aspects of the revised APS 120."[9]

However, we note that APRA intends to retain the obligation for ADIs to "carry out written self-assessments of each securitisation in which they participate…"[10] We believe that APRA should similarly consider excluding funding-only securitisations from this requirement.

Capital relief securitisation

The Discussion Paper puts forward two options with respect to the treatment of securitisation for capital relief – a "significant credit risk transfer approach" and a "pro rata" approach.

COBA welcomes APRA's consideration of the "pro rata" approach as a possible alternative to the current arrangement. However, institutions from our sector have indicated that more information on how the "pro rata" approach would operate in practice is required before a definitive position can be formed on a preferred option.

ABCP securitisation

APRA's Discussion Paper proposes that ABCP securitisation programs "have sound funding arrangements in place to cater for a (hypothetical) two-year closure of securitisation markets."

COBA suggests that this proposal is overly prescriptive and unnecessary. This is an onerous requirement to place on ABCP securitisation which will limit its usefulness.

[8] Littrell, *Prudential Reform in Securitisation,* 2013, p. 8.
[9] APRA, *Discussion Paper – Simplifying the prudential approach to securitisation,* April 2014, p. 31.
[10] ibid.

It is in the interests of both the issuer and the facility provider to find an alternative source of ongoing funding in any scenario where securitisation market conditions become more challenging. As such, we believe this requirement is unnecessary and the current arrangements should be retained.

ABCP Securitisation and liquidity

In considering liquidity obligations for MLH ADIs, the Discussion Paper notes that for ABCP securitisations "originating ADIs will be required to include the liabilities of the SPV in the calculation of the MLH ratio," while for warehouse SPVs "the originating ADI will not be required to include the liabilities of the SPV in the calculation of the MLH ratio."

In the case of ABCP securitisation, where there is no requirement for the issuer to repurchase the loans, a liquidity facility can achieve the same outcome for the issuer as if the loans were funded by a traditional warehouse. Where such an arrangement exists, it would be appropriate for that ABCP securitisation to receive the same liquidity treatment as a warehouse SPV.

Trust-Back arrangements (Seller Trust Assets)

Under the current APS 120, seller trust loans attract a risk weighting of at least 100 per cent, which compares with 35 per cent if the related securitised loan was not securitised.

While acknowledging that the seller trust loan is typically subordinated to the securitised loan (meaning that the securitised loan has first right to the shared collateral), for those seller trust facilities which give the issuer an unequivocal right to sell the property, we believe that seller trust loans pose no additional credit risk to the issuing ADI.

COBA recommends that formal trust back arrangements should be recognised and a capital charge equivalent to what would be required if the related loan was not securitised should apply.

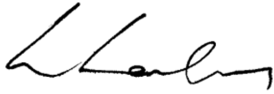
Investments in other ADI's securities

The Discussion Paper proposes that "…any ADI investing in anything other than the senior classes of any securitisation issued by any type of issuer will attract a CET1 deduction." APRA has proposed this approach given their view that such holdings can lead to increased levels of contagion or systemic risk.

While a CET1 deduction may be appropriate in the case of B class securities, not all non-senior classes are B class. Current securitisations include non-senior classes which are AAA rated and RBA repo eligible (AB class securities). As such, COBA believes that the application of the CET1 deduction should be limited to B class securities.

Please contact me on 02 8035 8448 or Micah Green on 02 8035 8447 to discuss this submission.

Yours sincerely



LUKE LAWLER
Acting Head of Public Affairs