



31 July 2014

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

**By email**

Dear Mr Grummitt

Members Equity Bank Limited (**ME Bank** or **the Bank**) welcomes the opportunity to provide its observations and comments on the Australian Prudential Regulation Authority's (APRA's) Discussion Paper "*Simplifying the prudential approach to securitisation*", 29 April 2014 (**Discussion Paper**).

**General Comments**

Securitisation continues to represent an important part of the funding plans for ME Bank. The Bank has exposure to term securitisations, warehouse facilities and to associated liquidity facilities. The Bank has no exposure to associated derivative facilities.

The use of securitisation is an important avenue to competitive funding for the Bank, given the relative rating of unsecured debt issuance to our competitors. The access to capital relief is also an important factor that levels the playing field with our competitors.

As the Bank submitted in the Regional Banks' Submission to the Financial System Inquiry: *'Levelling The Playing Field'*, the capital treatment of residential assets is currently uneven in Australia.

Whereas the advanced accredited banks apply risk weighting factors of less than 20% to their residential mortgage exposures, the banks applying the standardised approach are required to apply risk weightings of 35% or more.

The proposed changes to APS120 include a focus on 'skin in the game' amendments which the Bank would support. This support is, however, subject to an equitable application of the provisions for all market participants. We would advocate that APRA consider reducing the risk weight of these 'skin in the game' exposures from 35% (or more) to 20% to reflect the risk profile of these assets and to create a more level competitive environment.

**Specific Comments**

The Bank has some specific comments to make about the proposed changes as they relate to the business operated by ME Bank.

The Bank is impacted by the standard due to its use of capital relief term issuance, capital relief warehouse facilities and the provision of various liquidity facilities.

**Funding versus Capital Relief Transactions**

Currently ME Bank seeks capital relief for all of the securitisation transactions it conducts, other than internal securitisation. In the future the Bank is likely to enter into both funding only and capital relief transactions, depending on the purpose of the transaction and the market circumstances at the time.

APS120 states that 'Originating ADI's will need to designate each securitisation as funding-only or for capital relief at the inception of the transaction'. ME Bank would seek clarity on the timing of inception. It is possible that a capital transaction may become unachievable during the marketing phase of the deal, and it would be beneficial for issuers to have the flexibility to redesignate the transaction prior to final pricing.

**Capital Relief Transactions**

The Bank is impacted by the standard due to its use of capital relief term issuance, capital relief warehouse facilities and the provision of various liquidity facilities.

<i>Exposure</i>	<i>Current Treatment</i>	<i>Proposed Treatment</i>
Capital Relief Term Issue	Full capital relief provided all junior notes are sold	Retain a minimum of 20% 'skin in the game'
	Capital relief is based on significant credit risk transfer.	Skin in the game may be higher depending on proportion of Class B notes sold (Pro Rata Approach)

Comment

While the significant credit risk transfer approach ensures that the Bank achieves maximum available credit relief, it does require judgement and thus there is less clarity. The Pro Rata Approach provides more clarity and if APRA's purpose in introducing changes to the standard is, as the discussion paper states in the Executive Summary, to make the prudential framework "clear and simple", then ME Bank submits the Pro Rata Approach better achieves this.

**Class B Structures for Capital Relief Transactions**

Debt investors currently have a strong appetite for all forms of Class B bonds in securitisation structures. The recent experience of the Bank is that many investors in the lowest tranches of transactions are happy to participate all the way down the structure.

In a functioning market there should be appetite for exposure to the junior notes irrespective of whether there are multiple tranches or a single tranche. The ultimate structure of the junior notes is driven by the desire to meet investor demand and optimise the cost to the issuer.

The weighted average cost of tranches subordinate to the A notes in our recent SMHL 2014-1 transaction was approximately 160 basis points over 1 month BBSW. It is uncertain what the impact of consolidating junior tranches would have been on investor demand and thus price. If relative credit exposures are maintained then there should be minimal impact on the overall price outcome for issuers.

**Warehouses**

<i>Exposure</i>	<i>Current Treatment</i>	<i>Proposed Treatment</i>
Capital Relief Warehouse	Full capital relief provided all junior notes are sold.	Capital relief will only be available up to 80%
	No time limit on capital relief	Concessional capital treatment limited to assets held in warehouses for less than 1 year.

Comment

ME Bank makes significant use of warehouse facilities and these facilities currently provide capital relief by

selling the junior notes to a third party. Capital relief in warehouses is an efficient way for mutuals to manage not only liquidity but also capital adequacy requirements.

The proposed warehouse arrangements seek to limit the term of any concessional capital relief to assets that are held within warehouses for less than 1 year. It is not clear from the discussion paper how it is proposed that this limit would work. Warehouses are substantially termed out on a regular basis. The Bank is incentivised to do so by the relative pricing structure of warehouses compared to term issuance.

In any term issuance process there are assets that will remain in warehouses because they do not meet the criteria for the Term Structure. An example is loans in arrears. If the assets sit within a capital relief warehouse then it is assumed, as in the current standard, that they also cannot be repurchased by the originator. The question becomes what steps the originator can undertake to facilitate this proposed clause.

It is also not clear at what level the capital penalty will apply, the loan level or the facility level. This has the potential to impact on the cost of these facilities to users of warehouses as providers will need to build in the potential capital risk.

ME Bank agree that there needs to be a mechanism for ensuring that warehouses are termed out on a regular basis but we see the imposition of a specific 1 year limit as problematic. One option may be to trigger the term out of a facility if the facility has been substantially fully drawn for a period of time. This may involve a price step up mechanism to incentivise term out of the warehouse

#### **20% Securities Holding Limit.**

ME Bank notes the removal of the 20% securities holding limit. This will facilitate the holding of Class B notes in funding transactions as pools amortise. The proposal in relation to Class A bonds is less clear and the Bank would seek clarification on the meaning of "incidental to normal activities" in the context of the discussion paper.

#### **Global Issuance**

ME Bank actively promotes and receives investment in RWBS structures from global investors. Most recently that investment has come from entities regulated by the European standards. ME Bank would encourage APRA to develop the standard to allow as close an alignment with global standards as possible to maintain the competitiveness of offshore funding. The Bank is concerned that a multiplicity of 'skin in the game' requirements could impose a cumulative impact on issuers, rather than a single measure that would meet multiple jurisdictional requirements. (For example, in the European jurisdictions ME Bank will maintain a 5% representative sample, which might meet the Pro Rata Approach.)

#### **Queries**

ME Bank would be very happy to discuss the comments in this submission with APRA, or provide any additional detail APRA might require.

Yours sincerely



Isobel Rogerson  
Company Secretary