

31 July 2014

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

Dear Mr Grummitt,

CHAPTER 4 OF DISCUSSION PAPER: SIMPLIFYING THE PRUDENTIAL APPROACH TO SECURITISATION

Introduction

This submission is made by the Pepper Australia Pty Ltd group ("Pepper"). Pepper is a diversified, independent global financial services business with specialist experience in our core disciplines of lending, advisory and asset management across residential and commercial property and consumer, auto and equipment finance. Pepper offers home loan products to both prime and non-conforming borrowers and sources a significant proportion of its funding from the warehouse and term securitisation markets. Established in 2001, Pepper has been a regular RMBS issuer, having issued in excess of A\$5 bn of securities through 12 non-conforming and 3 prime backed issues.

As a non-bank lender, Pepper plays an important role as being an alternative to the banks as a source of housing and leasing finance for consumers. We are also one of the few providers of specialist or non-conforming loans, which is an important segment of the market that is underserved by the banks.

Pepper currently has 1, 2 and 3 year term warehouse facilities provided by various ADI's. These warehouses provide interim funding whilst Pepper builds sufficient volume and loan performance history (for new products or asset types) prior to terming out to market by means of a securitisation transaction. Whilst typically Pepper will issue one or more securitisations in a 12 month period, there can be occasions where this may not be possible, either because insufficient volume has been originated or securitisation markets are not suitable for issuance. It is also possible that whilst we have been able to term out the vast majority of the loans within 12 months, some loans may not have been able to be included in a securitisation because they do not comply with the eligibility criteria of the term securitisation at that time (eg. loans in arrears).

Access to competitively priced warehouse and term securitisation funding is essential to Pepper and other non-ADIs being able to continue to fund new lending activities. Pepper is concerned that some of the changes to APS120 being proposed by APRA in relation to warehouse arrangements will increase the price and reduce the availability of warehouse funding to non-ADIs, thus reducing Peppers and other non-ADIs ability to continue to be compete in the markets we operate in today.

We think it is important to note that non-ADI warehouses are structured to ensure the senior lender (ADI) is well protected from a credit risk standpoint, with subordination from the issuer and often non-ADI mezzanine investors. Further, as there is no "capital relief" for a non-ADI originator, concerns in regards to capital leakage do not exist in relation to warehouses provided to non-ADIs.

Areas of Concern

We have the following main concerns with the changes APRA is proposing to make to warehouse arrangements;

- Higher capital imposition where assets remain in a warehouse for longer than one year;
- Not allowing clean-up calls in warehouse structures;
- The imposition of a Common Equity Tier 1 deduction to an ADI's investment in "anything other than the senior classes" of a securitisation

Our concerns in regards to each of these matters are as follows.

Higher capital imposition where assets remain in a warehouse for longer than one year

Within Chapter 4 "Warehouse Arrangements" it is proposed that if residential mortgages remain in a warehouse for longer than a year the ADI providing the warehouse will incur a capital charge as if the assets were on its balance sheet. We understand that the main concerns APRA is seeking to address here are;

1. to prevent capital leakage from the banking system; and
2. liquidity issues for the warehouse provider associated with rollover / refinance risk.

It would seem to us that the potential for capital leakage only applies to warehouses provided to ADIs where the originating ADI seeks capital relief, and not in respect of warehouses provided to non-ADIs.

In regards to the liquidity concern, we suggest that a more appropriate way to address this would be through liquidity requirements under APS210. Accordingly, we request that APRA not proceed with this proposed change in regards to, as a minimum, warehouses provided to non-ADIs.

Clean-up calls in warehouse structures

Within Chapter 4 "Warehouse Arrangements" it is stated that "APRA would not normally envisage a role for clean-up calls in warehouse structures". We understand why APRA might have concerns with an originating ADI calling a warehouse for which they don't carry capital (i.e. the originating ADI has claimed capital relief for the warehouse). In contrast, we contend that the ability for a non-ADI to fully repay a warehouse via the exercise of a clean-up call would actually be of benefit to the ADI provider of the warehouse and thus to the banking system. We therefore request that APRA not proceed with this restriction, else allow clean-up calls in warehouses provided to non-ADIs.

Common Equity Tier 1 deductions in respect of investment in "anything other than the senior classes" of a securitisation

Within Chapter 4 "Other B class and / or subordinated holdings from any issuer" APRA is proposing to apply a Common Equity Tier 1 (CET1) deduction to an ADI's investment in "B Class Securities" / "anything other than the senior classes" of notes. The distinction between senior ("A class") and junior ("B class") securities is arguably clear for LMI insured RMBS, and so characterises the majority of RMBS issuance by ADIs.

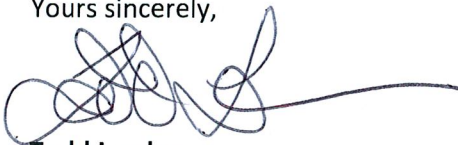
However, absent LMI there will be a number of classes of securities, typically one for each rating level (ie. AAA, AA, A, BBB). This is the case for auto ABS and non-conforming or uninsured prime RMBS issues, which are more typically issued by non-ADIs. With such issues, it is not as clear as to where the line would be drawn between senior and junior securities. We think that to impose a CET1 deduction on anything below the most senior tranche, or even on any tranche rated less than AAA would be punitive and would lead to an increase in funding costs for non-ADIs. We would request that "senior" be defined as being any investment grade security not being the most junior security, and thus limiting a CET1 deduction to investment in any tranche with a rating less than BBB.

Conclusion

The application of the proposed changes to APS120 highlighted above will likely result in increased costs being passed on by ADIs to non-ADI borrowers, and ultimately onto the consumer. This would make it difficult for smaller ADIs and non-banks to compete with larger ADIs who do not solely rely on warehousing and term securitisation as a source of funding.

We would appreciate APRA reconsidering the proposed amendments detailed above due to the adverse consequences such changes are likely to have on the non-bank sector and which could lead to a substantial reduction in competition to the detriment of the consumer.

Yours sincerely,



Todd Lawler
Group Treasurer