25 July 2014

QUEENSLAND POLICE CREDIT UNION

PO Box 13003, George Street Qld 4003
Level 1, 231 North Quay, Brisbane Qld 4000

www.qpcu.com.au
info@qpcu.org.au

Phone: 13 77 28
Fax: (07) 3236 2194
Loans Fax: (07) 3211 3683

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,

RE: Discussion Paper on Simplifying the Prudential Approach to Securitisation

I am writing in response to the above paper released by APRA on 29 April 2014 to outline Queensland Police Credit Union Ltd (QPCU)'s views in respect of the key issues from the discussion paper.

Our views are outlined in the attached submission and the key points are:

- All ADIs should have fair and equal access to securitisation;
- Access to securitisation for smaller ADIs, such as Mutual Banks, Credit Unions and Building Societies, is important for 4 reasons:
    - As a tool to support balance sheet growth;
    - As a risk management tool to provide an important relief valve for short to medium periods of capital and liquidity pressure caused by balance sheet growth;
    - As a profitability management tool, to ensure the most economic funding cost, which ultimately leads to maximising profitability and therefore maximising capital reserves over time; and
    - As a tool to better align tenure of liabilities with assets.
- Mutual Banks, Credit Unions and Building Societies should be afforded economically viable opportunities to participate in securitisation markets through multi-seller programs;
- APRA should consider amendments to the proposed framework to introducte provisions that apply only under certain volume 'caps' as a means of aligning desired prudential and economic outcomes.

Overarching, QPCU acknowledges APRAs desire to align with the Basel Committee's principles in relation to Securitisation and also acknowledges the difficulties associated with accommodating multi-seller programs within the principles outlined therein, in particular the 'skin in the game requirement'. QPCU also acknowledges the prudentially and economically successful operation of the Trinity Program for a period of over 15 years and believes that any new regime should accommodate its future, despite some of the practical difficulties in achieving regulatory 'one size fits all' principles.

Background and the Securitisation Needs of Smaller ADIs

Indue created and has operated a multi-faceted securitisation program specifically designed to meet the needs of smaller ADIs for the past 15 years (the "Trinity Program").

The Trinity Program is very different in structure to typical securitisation programs that are managed and under the direct control and influence of the originating ADI. Indue's program is a multi-seller program that operates on the basis of a clean sale of assets through to a Special Purpose Vehicle that is managed by Indue, not by the originating ADIs. Importantly, the Management and Board structure that is present in the Trinity Program is at arms-length from the Originating ADI, which is an important difference in this structure to other structures APRA may be familiar with. Further, no single ADI is responsible or charged with part or all of another ADI's losses other than through a potential reduction distributed to excess spread.

The program has been in operation since 1999 with a program size ranging up to $300m. The program has experienced no losses in its 15 years of operation. However in that time Trinity has never reached sufficient scale to term out which we believe is symptomatic of the smaller ADIs we deal with, the aggregate amount of loans they sell from time to time and their reasoning for sale.

Smaller ADIs (typically Mutual Banks, Credit Unions and Building Societies) have a need for Securitisation. This need has traditionally been met by multi-seller structures because of practical issues of economics (i.e.: without the ability to spread the fixed costs of a structure over a larger pool of assets, the structure is not viable for these entities).

In particular access to securitisation for smaller ADIs provides:

- an alternative source of funding (funding diversification);
- a source of longer dated funding (better matched to lending profile);
- an on-going liquidity management support tool;
- an emergency liquidity management support tool; and
- an on-going capital management support tool.

Mutual ADIs in particular have limited access to capital alternatives. Access to economically viable securitisation structures provides them with 2 important outcomes in relation to managing this structural capital impediment:

- a heightened ability to maximise profits through optimising funding costs for their assets and therefore maximising capital reserves over time; and
- a temporary capital relief valve to enable entities to capitalise on periods of high asset growth.

Multi-seller securitisation programs have proven themselves to operate successfully over the long term in the Australian market without any negative prudential consequences and many positive economic benefits. For smaller ADIs, multi-seller programs are the only economically viable securitisation structures available to them and it is important that these programs be afforded fair and equal access under the prudential regime.

Credit Risk Retention in Multi-Seller Programs (Skin in the Game)

Indue has consulted collaboratively with APRA in relation to this issue and acknowledges the regulatory desire to implement a one size fits all approach, however also acknowledges incorporating risk retention within these structures is, at best, going to fail the principle of simplicity and unlikely to be economically viable, and, at worst, is not achievable.

QPCU's view is that the most pragmatic approach to resolving this important matter may be to consider the introduction of provisions that apply under certain conditions specifically designed to assist smaller entities to achieve access to funding in an environment where they can only do so through a multi-seller structure. This could be undertaken through a principles based approach relative to the overall structure and achieving transfer of credit risk.

It is submitted that these provisions could be restricted to apply only in circumstances where the bond size was under a certain threshold and where there was more than 1 party to the securitisation with certain limitations on the proportion of the issuance undertaken by each party to the securitisation. It is considered that the inclusion of such provisions would prevent the provisions being subject to 'gaming' as multi-seller arrangements are only pursued out of economic necessity.

Ultimately there will be a natural limit for the amount of appetite in the financial sector for multi-seller programs due to their nature. This places a natural (very low) cap on the amount of securitisation structures that can access alternate provisions, while at the same time providing practical and important access to professional funding markets otherwise out of the economic reach of smaller players.

Warehouse Arrangements

QPCU acknowledges APRAs points in respect of the potential long nature of some warehouse structures, given the volume hurdles required to be met to enable clearing the warehouse. The Trinity Program has been one such structure and notwithstanding this it has nevertheless met a market need for smaller ADIs by operating in this manner for some 15 years.

Specifically QPCU's views in relation to the points on page 24 of the discussion paper are:

- the first two points revolve around imposing a 'skin in the game' requirement. Our view in respect of this is the same as that which we outlined in the section above and we believe a similar approach to a revised ('principles based') rule set applying when certain conditions around multi-sellers and volume are met. One approach could be to include a requirement to meet capital relief requirement under APS 120, where these conditions are met;
- the third point refers to the '12 month rule', requiring a differing capital treatment for the warehouse funder after 12 months. From a multi-seller warehouse perspective where loans are sold to the SPV at differing times, a definition of timeframe should be included to clarify if the 12 month rule applies from the date of sale of loans to the warehouse in respect of those loans only or if this rule applies 12 months from the date of inception of the warehouse regardless of date of sale of loans.
- the fourth point is in relation to warehouses being temporary and therefore not requiring a clean up call, however this seems to be more linked to the concessional nature of the capital treatment, than any in principle objection to clean up calls. This does also not contemplate the multi-seller warehouse used for smaller ADIs where volumes may never reach sufficient level to term out. Our view would be that the better approach is to address the issue in

respect of capital leakage by the warehouse provider rather than ban clean up calls as a matter of principle.

There would also seem to be a disparity between APRA regulated warehouse funders and non APRA regulated warehouse funders in that APRA can enforce the 12 month rule to APRA regulated funders but not to non-APRA regulated funders.

As these guidelines stand, the Trinity program would not meet the requirements of a securitisation warehouse and we firmly believe that amending the structure to meet skin in the game requirements would not be economically viable to achieve. This would result in the Trinity program operating as a commercial program outside the controls of APS120 or closure.

We thank you for the opportunity to put our views forward in respect of the changes to the regulatory regime and we would welcome the opportunity to meet with representatives of APRA to discuss our submission further. If you have any questions in relation to our submission, please contact me directly on [redacted].

Yours faithfully

Gabriel Romaguera
Acting Chief Executive Officer