

## **3.2 AUSTRALIA**

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### **I. FRAMEWORK**

The legal framework is principally contractual, with a statutory overlay enshrined in the Australian Banking Act (Cth) 1959 (Banking Act). The Banking Act contains certain minimum requirements for a covered bond programme (which are discussed in greater detail below) including requirements as to the assets eligible for inclusion in the cover pool, the appointment of a cover pool monitor, the requisite qualifications for a cover pool monitor, minimum overcollateralisation requirements and a cap on issuance. The Banking Act also empowers the Australian bank regulator, the Australian Prudential Regulation Authority (APRA), with certain powers including the power to determine Prudential Standards in relation to covered bonds.

### **II. STRUCTURE OF THE ISSUER**

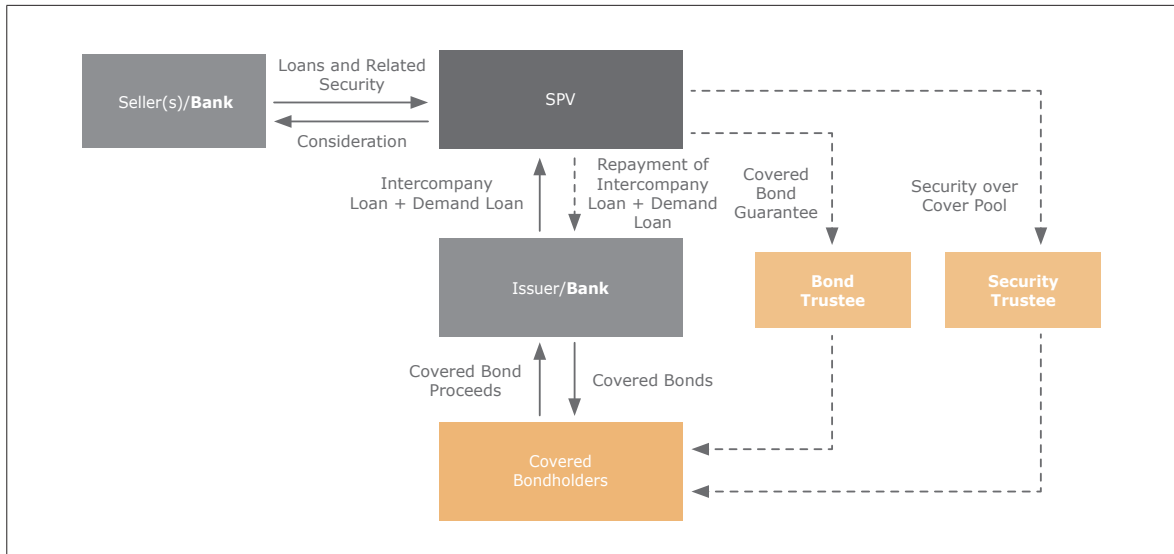
Australian banks, referred to under the Banking Act as “authorised deposit-taking institutions” or “ADIs”, are the issuers of covered bonds; not SPVs or any other entity. However, a covered bond special purpose vehicle (the Covered Bond Guarantor) is established which holds the cover pool assets acquired by a true sale from the issuer. The Covered Bond Guarantor is in the form of a trust. It provides a guarantee over the issuer’s obligations in respect of issued covered bonds, which guarantee is secured by the granting of a security interest over the cover pool assets in favour of a security trustee.

The guarantee will be called upon if an event of default in respect of the issuer were to occur. At such time, the Covered Bond Guarantor will be required to pay interest and principal on the covered bonds in accordance with the original payment schedule and payments under the covered bonds will not be accelerated. In addition, at such time, the bond trustee (on behalf of the covered bondholders) will make a claim, as an unsecured creditor, against the insolvency estate of the issuer bank. Any amount recovered against the insolvency estate of the issuer bank will be paid to the Covered Bond Guarantor to be held as additional collateral in the cover pool and to be used to make payments under the guarantee.

If an event of default were to occur in respect of the Covered Bond Guarantor, payments under the covered bonds would then be accelerated and become immediately due and payable.

Under the Banking Act, an issuer bank must not issue covered bonds if the value of the assets in the cover pool exceeds 8% of the issuer bank’s assets in Australia. Further, if the issuer bank exceeds the 8% cap on issuance in breach of the Banking Act, it will also attract a deduction from its regulatory capital base equal to the value that exceeds 8%.

> FIGURE 1: STRUCTURE



Source: Australian Securitisation Forum

### III. COVER ASSETS

Section 31<sup>1</sup> of the Banking Act sets out the assets that can be included in the cover pool. These are:

- a. an at call deposit held with an ADI and convertible into cash within 2 business days;
- b. a bank accepted bill or certificate of deposit that:
  1. matures within 100 days; and
  2. is eligible for repurchase transactions with the Reserve Bank; and
  3. was not issued by the ADI that issued the covered bonds secured by the assets in the cover pool;
- c. a bond, note, debenture or other instrument issued or guaranteed by the Commonwealth, a State or a Territory;
- d. a loan secured by a mortgage, charge or other security interest over residential property in Australia;
- e. a loan secured by a mortgage, charge or other security interest over commercial property in Australia;
- f. a mortgage insurance policy or other asset related to a loan covered by paragraph (d) or (e);
- g. a contractual right relating to the holding or management of another asset in the cover pool;
- h. a derivative held for one or more of the following purposes:
  1. to protect the value of another asset in the cover pool;
  2. to hedge risks in relation to another asset in the cover pool;
  3. to hedge risks in relation to liabilities secured by the assets in the cover pool.

The value of assets in the cover pool which are bank accepted bills or certificates of deposit as referred to in paragraph (b) above must not exceed 15% of the face value of the issued covered bonds.

At the time of publication, all Australian covered bond issuers have limited their programmes to residential mortgage collateral for their cover pools and no such programmes include commercial mortgages.

<sup>1</sup> [http://www.austlii.edu.au/au/legis/cth/consol\\_act/ba195972/s31.html](http://www.austlii.edu.au/au/legis/cth/consol_act/ba195972/s31.html).

## **IV. VALUATION AND LTV CRITERIA**

Contractually, cover pool assets are subject to revaluation every month by way of indexation, which varies between programmes. Please refer to each issuer's individual website for details of the index used and the methodology applied.

LTV criteria – in addition to indexation, for the purposes of calculating the minimum overcollateralisation requirements contained in Section 31A<sup>2</sup> of the Banking Act as well as the monthly asset coverage testing, the following LTV requirements apply:

- > Residential mortgages – if the mortgage loan exceeds 80% of the value of the mortgaged property securing that loan then the value of the loan is reduced by the amount of the excess; and
- > Commercial mortgages – if the mortgage loan exceeds 60% of the value of the mortgaged property securing that loan then the value of the loan is reduced by the amount of the excess.

## **V. ASSET – LIABILITY MANAGEMENT**

This is principally a matter for the credit rating agencies in relation to timely payment and their opinions on the value of the pool in liquidation scenarios. The issuers have regard to ECAI's methodologies and criteria to seek to ensure maintenance of AAA ratings.

## **VI. TRANSPARENCY**

Since August 2012, an Australian Transparency Template has been in force, followed by each of the eight Australian covered bond issuers. It is in line with the guidelines of the ECBC's Covered Bond Label Initiative, and covers the following areas of each issuer's programme:

- |           |                 |                        |
|-----------|-----------------|------------------------|
| > Dates   | > Prepayments   | > Compliance Tests     |
| > Ratings | > Pool Summary  | > Bond Issuance        |
| > Parties | > Mortgage Pool | > Asset Coverage Tests |

## **VII. COVER POOL MONITOR AND BANKING SUPERVISION**

The Banking Act requires that a cover pool monitor be appointed in respect of a cover pool. The cover pool monitor must either be a registered auditor or hold an Australian financial services licence that covers the provision of financial services as the cover pool monitor. The cover pool monitor is appointed by the bank issuer but must be independent and must provide reports in respect of the cover pool to, amongst others, APRA on request. The Banking Act requires the cover pool monitor to undertake specific functions, and report on such functions, biannually. Those functions involve assessing and reporting on the following:

- > compliance with the 103% statutory minimum overcollateralisation requirement;
- > compliance of the assets in the cover pool with the eligibility requirements under the Banking Act; and accuracy of cover pool asset register.

In addition, the cover pool monitor is also required contractually to check the arithmetic accuracy of the asset coverage tests on an annual basis.

As the regulator of banks in Australia, APRA has some general powers under the Banking Act with respect to bank issuers but not the Covered Bond Guarantor. For example, under section 11CA(2) of the Banking Act APRA may give a direction to a bank issuer not to transfer any amount or asset to a cover pool. However, APRA may only give such directions in specific and limited circumstances including when APRA has reason to believe that the bank issuer is unable to meet its liabilities, there has been a material deterioration in the bank issuer's financial condition, the bank issuer is conducting its affairs in an improper or financially unsound way, the

<sup>2</sup> [http://www6.austlii.edu.au/cgi-bin/viewdoc/au/legis/cth/consol\\_act/ba195972/s31a.html](http://www6.austlii.edu.au/cgi-bin/viewdoc/au/legis/cth/consol_act/ba195972/s31a.html).

failure to issue a direction would materially prejudice the interests of the bank issuer's depositors, or the bank issuer is conducting its affairs in a way that may cause or promote instability of the Australian financial system.

#### **VIII. SEGREGATION OF COVER ASSETS AND BANKRUPTCY REMOTENESS OF COVERED BONDS**

Cover pool assets are sold by the bank issuer to the Covered Bond Guarantor, which is a special purpose trust. The sale is a true sale and will be enforceable against the issuer in the event of its insolvency. In addition, the Covered Bond Guarantor will grant a security interest over the cover pool assets in favour of a security trustee which will be recognised at law and will not be enforceable against the Covered Bond Guarantor in the event of its insolvency.

#### **IX. RISK-WEIGHTING & COMPLIANCE WITH EUROPEAN LEGISLATION**

Not in compliance with UCITS because Australian issuers are not domiciled in member states of the EEA.

Risk weighting varies depending upon the jurisdiction concerned, pending standardised risk-weights from the EBA and the outcome of the current Basel consultation.

Covered bonds issued by Australian issuers are currently not eligible assets for repurchase agreements with the ECB or NCBs, or the BoE. There is, however, a view that some Australian covered bonds may be eligible for inclusion in the calculation of LCR in some regulatory jurisdictions.

Covered bonds issued by Australian issuers and denominated in Australian dollars are repo eligible with the Reserve Bank of Australia subject to satisfying an assessment by the Reserve Bank of Australia and the issuer meeting disclosure requirements on an ongoing basis. Furthermore, covered bonds may qualify as Level 2 High Quality Liquid Assets (HQLA2A) for liquidity purposes under APRA's implementation of Basel III LCR guidelines.

There are no special Australian federal or state investment regulations regarding Australian covered bonds.

#### **X. ADDITIONAL INFORMATION**

The development of the Australian covered bond market largely came about due to the financial crisis and the effective seizure of non-sovereign global capital markets through this period. After the events of 2008 and 2009, the Australian Federal government recognised the need for increasing funding diversity within the Australian banking system. The Australian Federal government subsequently passed changes to the Banking Act, enabling banks to issue covered bonds in the form prescribed by the Banking Act. The first covered bond issuances from Australian banks occurred in late 2011. Issuance volumes subsequently increased dramatically through 2012 as issuers properly established their programmes in global bond markets.

In principle, Australian ADIs have three primary term funding options for their balance sheets: senior unsecured bonds, residential mortgage backed securitisation and covered bonds. In practice, the larger institutions have effective access to all three options while smaller institutions principally issue senior unsecured bonds and residential mortgage backed securities for term funding.

It is expected that Australian covered bond issuers will continue to use their issuance capacity sparingly; balancing maintaining a global market presence against the higher all-in funding costs associated with covered bonds and program management costs (in comparison to funding through senior unsecured bonds or residential mortgage backed securities), and the need to be able to respond quickly to deterioration in funding conditions. Feedback from a range of market participants suggests that this funding strategy may drive a scarcity premium in terms of the relative valuation of Australian covered bonds against other forms of Australian bank secured financing and other global covered bond markets.

**Issuers:** There are eight issuers of Australian covered bonds. These are Westpac Banking Corporation, National Australia Bank Limited, Australia and New Zealand Banking Group Limited, Commonwealth Bank of Australia, Suncorp Bank, Macquarie Bank, Bank of Queensland and ING Bank Australia. These eight Australian based banks have primarily issued soft bullet covered bonds. However, Bank of Queensland has issued conditional pass-through covered bonds (CPTCB) and is the first Australian ADI to issue a covered bond in that format.

**For the most up-to-date information, please consult the new ECBC Covered Bond Comparative Database webpage on the Covered Bond Label website [www.coveredbondlabel.com](http://www.coveredbondlabel.com).**

In the context of the transposition of the Covered Bond Directive (the final deadline for which was 8 July 2022), the ECBC has undertaken a full review and update of the Covered Bond Comparative Database to take account of the latest regulatory developments. This unique reference tool can be accessed via the link hosted on the Covered Bond Label website ([www.coveredbondlabel.com/legislation/comparative\\_database](http://www.coveredbondlabel.com/legislation/comparative_database)).

For further national information on the Australian market, please see [compare.coveredbondlabel.com/frameworks](http://compare.coveredbondlabel.com/frameworks). To access the "Country Comparison" feature of the database, please see [compare.coveredbondlabel.com/compare/select/frameworks](http://compare.coveredbondlabel.com/compare/select/frameworks).