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## **APRA takes a swipe at shadow banking**

In a surprising departure from script, the prudential regulator has used its revision of the rules covering securitisation to extend its reach to non-banks.

Last week the Australian Prudential Regulation Authority (APRA) released a discussion paper on the prudential standard that covers securitisation, APS 120. It most respects it was exactly in line with the proposals outlined by APRA's executive general manager, policy, statistics and international division, Charles Littrell, at last year's Australian Securitisation Forum (ASF) conference.

However the details covering warehouse funding have stirred the market.

At the conference last November, Littrell indicated APRA would be taking a stricter approach to warehouse funding.

Warehouse funding is the means by which mortgage lenders temporarily fund and remove home loans from their balance sheet before they've amassed sufficient loans to issue residential mortgage-backed securities (RMBS) for distribution to investors. It is essentially one bank, the warehouse facility provider, renting its balance sheet to another home loan lender.

Littrell said at the time that APRA would continue to give home loan lenders capital relief when warehouse facilities are used if the underlying assets are securitised within a year. But after 12 months, the arrangements will be treated as a whole loan sale by the originator to the warehouse provider.

### **Applies to non-ADIs as well as ADIs**

APRA has responsibility for authorised deposit-taking institutions (ADIs), not specialist lenders such as Bluestone, Liberty Financial and Pepper and non-bank lenders like Firstmac and Resimac. However in the discussion paper APRA has extended the stricter proposals around warehouse facilities to non-banks.

"The point that surprised me, and was additional to what Littrell said last year, is the piece on warehouse facilities," said James Austin, Firstmac's chief financial officer. "In this draft discussion document he has specifically said this applies to non-ADIs as well as ADIs."

Some small ADIs utilise warehouse facilities for long-term funding and get capital relief but without ever issuing RMBS, meaning there is a net reduction of capital in the banking system. Austin said capital neutrality is the objective of APRA and so these small ADIs should be the target of the warehouse facility rules, not the non-banks.

"In extending it to non-banks that don't have regulatory capital requirements, you're therefore increasing the amount of capital in the system," said Austin.

Firstmac has issued 23 publicly-rated RMBS transactions worth almost \$12 billion since September 2003 so it is obviously a regular issuer and not abusing the warehouse facilities.

"Will we have to time stamp the loans as they go into the facilities?" asked Austin. "It would be fairly obvious which ADIs are abusing the warehouse facilities. It seems a lot of effort to address that and I think it is an unintended consequence by extending it to non-banks."

## **Volumes at the expense of quality**

Robert Camilleri, an investment manager at Realm Investment House, is worried that APRA's stricter stance will cause lenders to focus on volumes at the expense of quality so they build up sufficiently large loan pools to securitise to meet the 12-month time limit.

"It particularly affects non-banks that target strategic markets," he said. "It may encourage non-banks, that aren't covered by the bank regulator, to begin writing larger volumes, with bad loans missing the wicket keeper."

In his opinion, there needs to be differential treatment between non-banks and ADIs.

"Twelve months is too short to write business in an orderly manner," said Camilleri.

## **'Well-seasoned' loan pools**

However last November Littrell expressed little sympathy for any lender that couldn't build up enough loans for an RMBS issue in that time frame. He said if it took that amount of time for a home lender to build a sizeable loan pool, it wasn't adding to competition and should look to merge with another entity to give it greater economies of scale.

Austin noted that investors prefer to buy RMBS backed by 'well-seasoned' loan pools, meaning the loans have been outstanding for two to three years.

"Seasoning is certainly valued by investors," he said. "This is encouraging issuers to put loans out the door with only six months seasoning."

David Goodman, Westpac's global head of global capital markets strategy, said the proposed change could see smaller RMBS deals coming to the market.

Another possibility is pre-funding transactions whereby an issuer does a \$500 million RMBS that is backed by only \$400 million of loans and investors will have to take it on trust that the issuer will add more loans to the securitised pool over time.

In essence, the investors would be providing a warehouse facility. This type of feature was prevalent prior to the global financial crisis but hasn't been seen since, according to Austin.

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