Australia Mortgage Covered Bond Programmes: Major Banks – Peer Review

Well Buffered Against Banks' Rating Downgrades

Three-Notch Buffer Against Downgrade: 'AAA' rated covered bonds can sustain a three-notch downgrade of a bank's Long-Term Issuer Default Rating (IDR), as the major Australian banks have IDRs of 'A+', while the bonds have total uplift above the respective IDR of seven notches. The Stable Outlook on the 'AAA' ratings reflects the buffer against an IDR downgrade.

Zero-Notch Resolution Uplift: There is no specific advanced resolution regime in Australia, but the Australian Prudential Regulatory Authority has the ability to resolve a bank under its regulatory powers under the Banking Act. Even so, covered bonds are not explicitly exempt from bail-in should a bank be resolved. This may result in the direct enforcement of recourse against the cover pool for the payment of the outstanding covered bonds.

Strong Liquidity Protection: All programmes have a six-notch payment continuity uplift (PCU), driven by the 12-month maturity extension on the soft-bullet bonds, providing liquidity gap protection. The programmes also provide for a reserve covering three months of interest and one-quarter of annual senior fees, which, with the exception of WBC, have been fully funded since 2020. WBC's reserve fund will be funded upon its IDR being downgraded below 'A-' and 'F1'.

Asset Credit Risk Stable: All pools are composed of prime Australian residential mortgages, with weighted-average (WA) loan-to-value (LTV) ratios of below 65% and limited adverse loan characteristics. NAB has the highest credit loss component among peers, as its cover pool contains the highest WA LTV and greater percentages of interest-only and investment loans than the peer average. Cover pool composition for all programmes has been stable over the last 12 months.

Good Recovery Prospects Given Default: The recovery uplift in all programmes is capped at one notch. This is because the programmes are exposed to foreign-exchange risk from recoveries given default of the covered bonds. There are swaps in place on the liabilities, but Fitch Ratings expects the swaps to terminate upon a covered bond default. This would mean the longer-dated Australian-dollar asset cash flow would need to provide recoveries for the foreign-currency denominated covered bonds.

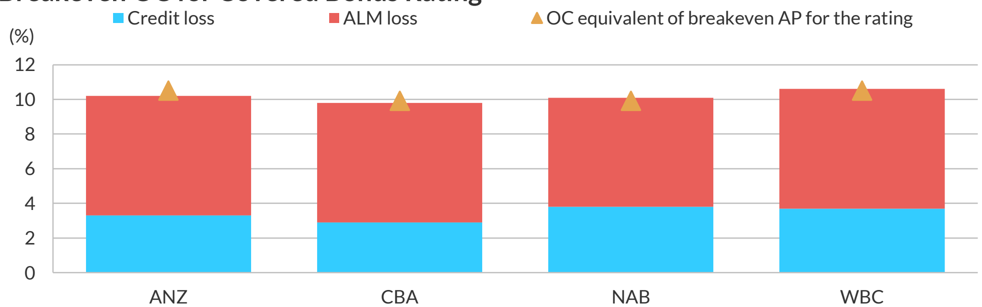
Asset Percentage Commitment Supports Rating: Fitch disregards the part of the overcollateralisation (OC) between the cover pool and the covered bonds owed by the covered bond guarantor to the issuer in the form of a demand loan. This is because the demand loan ranks senior in repayment to covered bonds, should recourse against the cover pool be enforced. Therefore, Fitch relies on the committed asset percentage (AP) used in the asset coverage test (ACT) and as stated in the covered bond investor reports.

Key Rating Drivers

Programme	Australia and New Zealand Banking Group Limited (ANZ)	Commonwealth Bank of Australia (CBA)	National Australia Bank Limited (NAB)	Westpac Banking Corporation (WBC)
Long-term IDR	A+	A+	A+	A+
Resolution uplift (notches)	0	0	0	0
PCU (notches)	6	6	6	6
Timely payment rating level	AA+	AA+	AA+	AA+
Recovery uplift (notches)	1	1	1	1
Covered bond rating	AAA	AAA	AAA	AAA
Covered bond Outlook	Stable	Stable	Stable	Stable
Buffer against IDR downgrade	3	3	3	3
Breakeven AP for rating (%)	90.5	91.0	91.0*	90.5
AP Fitch relies upon (%)	90.5	91.0	91.0*	90.5

[a]NAB's APs are as of 14 January 2022 after the issuance of its Series 37 covered bond.
Source: Fitch Ratings

Breakeven OC for Covered Bonds Rating



Note: NAB's ALM loss is as of 14 January 2022 after the issuance of its Series 37 covered bond.
Source: Fitch Ratings


Jimmy Tanzil
+61 2 8256 0305
jimmy.tanzil@fitchratings.com


Marija Buzevska
+61 2 8256 0340
marija.buzevska@fitchratings.com

All figures in this report are as of 31 December 2021 unless stated otherwise.

Cover Pool – Peer Analysis

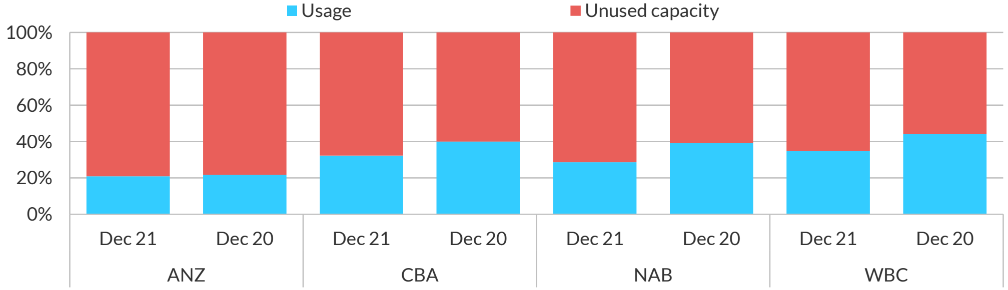
Cover Assets Credit Analysis

	ANZ	CBA	NAB	WBC
Covered bonds rating	AAA	AAA	AAA	AAA
Rating default rate (RDR) for rating (%)	10.3	8.4	12.0	11.3
Rating recovery rate (RRR) for rating (%)	61.1	56.1	60.8	60.4
Rating loss rate (RDR*(1-RRR)) for rating (%)	4.0	3.7	4.7	4.5
'B' case loss rate (%)	0.4	0.3	0.4	0.4

Source: Fitch Ratings

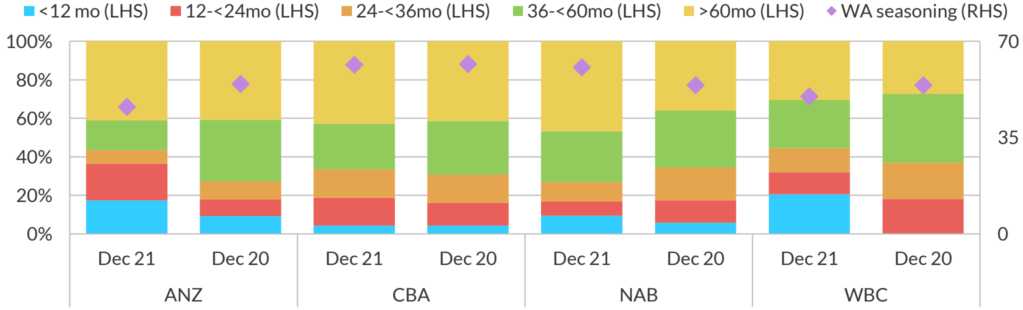
- All cover pools include first-ranking prime residential mortgage loans denominated in Australian dollars and backed by residential properties in Australia. The average 'B' portfolio loss rate for the four cover pools is 0.4%, which has remained mostly stable.
- CBA's cover pool exhibits the strongest credit characteristics among the peer group, with the lowest LTVs, high seasoning and low levels of interest-only and investment loans. The pool also has the highest proportion of loans with lenders' mortgage insurance (LMI), which have contributed to a low rating loss rate. This is followed by ANZ's pool, whose stronger credit quality is slightly offset by a higher WA LTV and no LMI credit for loans with ANZ LMI.
- Pre-credit to LMI, the rating loss rate for CBA and ANZ programmes' is floored at the minimum level defined in Fitch's criteria (4.0% at 'AAA') to account for idiosyncratic risks.
- NAB and WBC have higher RDRs among the peer group of 12.0% and 11.3%, respectively, driven by adverse credit characteristics. These include higher WA LTV ratios, particularly loans with LTVs greater than 80%, and a greater proportion of interest-only and investment loans than the peer average.
- No credit to LMI is given to the ANZ and WBC cover pools, as WBC's portfolio includes a small amount of LMI covered loans, mainly by Arch LMI, while ANZ's portfolio includes loans covered by ANZ LMI, neither of which are rated by Fitch.
- Loans with an interest-only period have been declining in the cover pools over the last 12 months, as interest-only terms end and the loans begin to amortise for the remainder of the mortgage term. Meanwhile, the proportion of fixed-rate loans has risen, given the historically low fixed-rates available to borrowers, with WBC's pool having more than 50% fixed-rate loans as of end-2021. This was well above that of peers.
- The cover pools maintain a low level of arrears, supported by Covid-19 pandemic relief packages provided by the banks and government. However, loans in 90+ day arrears are not given credit in the ACT calculation, so issuers tend to remove these loans from the pool.
- Cover pools are geographically concentrated in the eastern states of Australia.

Issuance Available Capacity



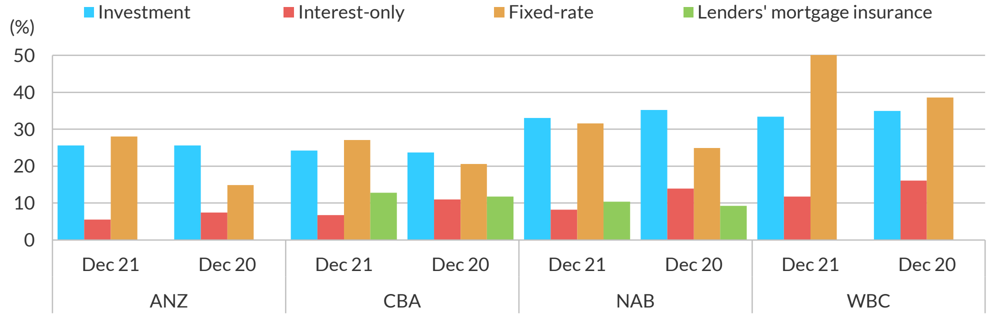
Capacity calculated as 8% of 31 December 2021 resident assets and includes overcollateralisation
Source: Fitch Ratings, APRA

Loan Seasoning (% of Residential Pool)



Source: Fitch Ratings, ANZ, CBA, NAB, WBC

Loan Type (% of Pool)



Source: Fitch Ratings, ANZ, CBA, NAB, WBC

Breakeven OC – Peer Analysis

Breakeven OC Components for the Ratings

Programme	ALM loss (%)	Credit loss (%)
ANZ	6.9	3.3
CBA	6.9	2.9
NAB	6.3	3.8
WBC	6.9	3.7

Note: NAB's ALM loss is as of 14 January 2022 after the issuance of its Series 37 covered bond.
Source: Fitch Ratings

Credit Loss

- The credit loss component reflects the stressed credit loss derived by Fitch under its analysis of each programmes' cover pool at the 'AA+' timely payment rating level. This is the driving scenario for the 'AAA' breakeven AP.
- The expected loss for all pools is low, reflecting strong credit quality and highly seasoned cover assets. NAB has the greatest credit loss, driven by a higher WA LTV, and a greater proportion of interest-only and investment loans in the cover pool than the peer average.

ALM Loss

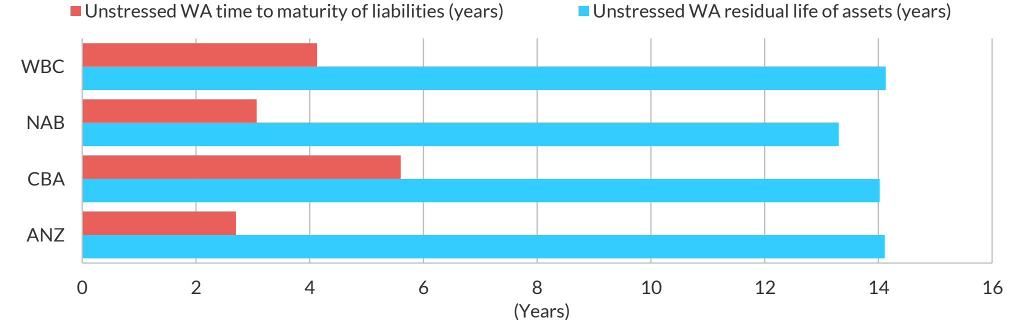
- ALM loss remains the largest component of Fitch's 'AAA' breakeven OC for the four programmes. This reflects the modelled asset and liability mismatches, inclusive of the modelled excess spread, taking into account the effect of the pro rata asset sales clause in the programmes. This clause limits the assets that can be sold to the pro rata proportion of the maturing bond.
- ALM loss components are largely affected by concentrated bond maturities in the liability profile of all four programmes as of the last analysis for each programme.
- Approximately AUD4.9 billion, or close to half, of ANZ's outstanding bonds mature in 2022, while AUD8.7 billion of CBA's bonds mature over the 12 months from November 2021. NAB's maturity concentration stems from the 12-month redemption period of AUD5.0 billion from December 2025. Meanwhile WBC's liability profile includes a significant AUD4.5 billion maturity in January 2025.
- Maturity concentration creates the need to sell more cover assets in our modelling and negatively affects the programmes' pro rata sales constraint, because it only allows the pro rata proportion of assets to be sold for the liabilities being redeemed. Therefore, a higher level of OC is needed to meet the required sale amount and not trigger the pro rata sale constraint.
- Covered bond swaps are in place to cover currency and interest-rate mismatches on the bonds until the extended due-for-payment date.

Cash Flow Analysis Driving Scenarios

Programme	Driving prepayment scenario	Driving interest-rate scenario	Driving default timing scenario
ANZ	Low	Stable	Front loaded
CBA	Low	Stable	Front loaded
NAB	Low	Decreasing	Front loaded
WBC	Low	Stable	Front loaded

Source: Fitch Ratings

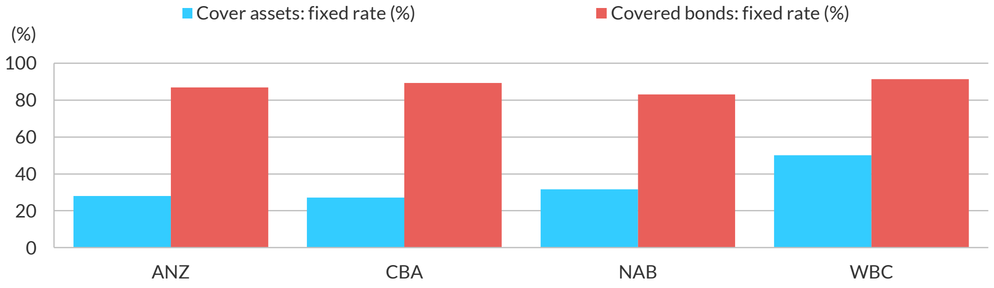
Unstressed Assets & Liabilities Maturity Mismatches (31 December 2021)



Source: Fitch Ratings

Pre-Swap Fixed Rate Assets and Liabilities Interest Rate Mismatches

At 31 December 2021



Source: Fitch Ratings

Resolution Uplift, PCU and Recovery Uplift – Peer Analysis

Continuity Uplift Assessment

Programme	Resolution uplift (notches)	PCU (notches)
ANZ	0	6
CBA	0	6
NAB	0	6
WBC	0	6

Source: Fitch Ratings

Resolution Uplift

- The Australian Prudential Regulation Authority (APRA) has the option to resolve Australian authorised deposit-taking institutions (ADIs) as part of its supervisory powers under the Banking Act. However, the framework does not contemplate giving specific powers to bail-in creditors.
- Australia's major banks, also known as domestic systemically important banks, will hold 3pp of risk-weighted assets as loss-absorbing capacity through existing regulatory capital instruments by 2024. As a consequence, covered bonds issued by the major banks will be more removed from any recapitalisation scenario following a resolution.
- The lack of an explicit exemption for covered bonds gives rise to the risk of cover pool enforcement. Australia does not give preferential treatment to covered bonds in the event of resolution against ADIs' senior unsecured debt, therefore, a resolution uplift of zero notches is granted to all Australian covered bond programmes.

PCU

- Our PCU assessment is driven by the weakest form of protection provided, where both hard and soft bullet bonds are issued. The assessment is based on the 12-month maturity extension on the outstanding soft bullet bonds for all four programmes. Our assessment of ANZ was previously based on a 12-month pre-maturity test (PMT) on the hard bullet bonds, which allows up to 12 months to sell assets. However, all of ANZ's hard bullet bonds mature within the next 12 months and are now fully collateralised, so the liquidity gap on the hard bullet bonds is no longer the weakest form of protection.

  CBA's PMT has a longer cure period of six months, providing less time to sell assets to repay the hard bullet bonds, if needed, although we do not think there is a high likelihood of it causing a cross-default on the soft bullet bonds due to the size and distribution of the remaining hard bullet bonds in the programme. Hard bullet bonds represented 15.6% of ANZ's outstanding covered bonds, 6.3% of CBA's and 2.8% of NAB's as of end-2021.
- The programmes provide for a reserve covering three months of interest and one-quarter of annual senior expenses, which, with the exception of WBC, were funded in April 2020. WBC's reserve fund will be funded if its IDRs are downgraded below 'A-' and 'F1'. This is in line with Fitch's minimum direct counterparty rating for a 'AA+' timely payment level.
- No other risks exist outside of liquidity on the PCU assessment.

Recovery Uplift Assessment

Programme	'AAA' credit loss (%)	OC Fitch relies on in its analysis (%)	Pre-swap foreign-currency bond exposure (%)	Maximum achievable recovery uplift (notches)
ANZ	4.2	10.5	93.1	1
CBA	3.8	9.9	98.1	1
NAB	4.9	9.9	87.2	1
WBC	4.7	10.5	88.4	1

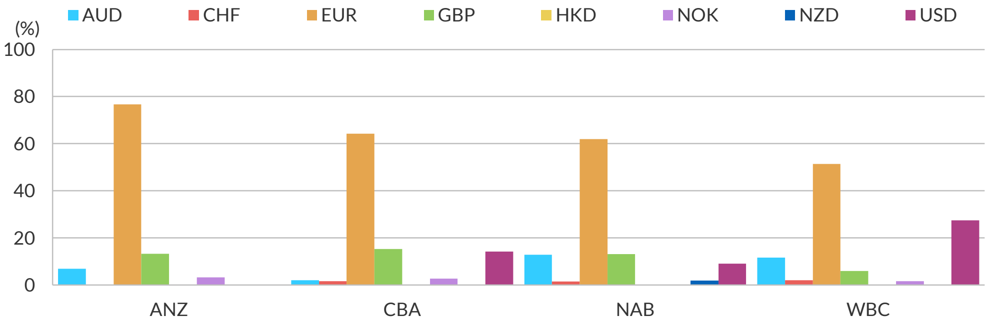
Source: Fitch Ratings

Recovery Uplift

All the programmes are granted a one-notch recovery uplift. This is driven by the:

- cover assets being standard Australian residential mortgage loans; and
- a recovery uplift cap, as the programmes are significantly exposed to foreign-exchange risk that could affect recoveries given a default of the covered bonds. There are swaps in place on the liabilities, but we expect the swaps to terminate upon a covered bond default. This would mean the longer-dated Australian-dollar asset cash flow would need to provide recoveries for the foreign-currency denominated covered bonds.

Covered Bonds by Currency (End-December 2021)



Source: Fitch Ratings, ANZ, CBA, NAB, WBC

ESG Considerations

ESG Relevance Scores Recap

		ANZ	CBA	NAB	WBC
Environmental (E)	GHG emissions & air quality	1	1	1	1
	Energy management	1	1	1	1
	Water & wastewater management	1	1	1	1
	Waste & hazardous materials management; ecological impacts	2	2	2	2
	Exposure to environmental impacts	2	2	2	2
Social (S)	Human rights, community relations, access & affordability	2	2	2	2
	Customer welfare – fair messaging, privacy & data security	3	3	3	3
	Labour relations & practices	1	1	1	1
	Employee wellbeing	1	1	1	1
	Exposure to social impacts	3	3	3	3
Governance (G)	Rule of law, institutional and regulatory quality	3	3	3	3
	Transaction & collateral structure	3	3	3	3
	Transaction parties & operational risk	3	3	3	3
	Data transparency & privacy	3	3	3	3

Source: Fitch Ratings

Credit-Relevant ESG Scale Definitions

How relevant are E, S and G issues to the overall credit rating?	
5	Highly relevant; a key transaction or programme rating driver that has a significant impact on an individual basis
4	Relevant to transaction or programme ratings; not a key rating driver, but has an impact on the ratings in combination with other factors
3	Minimally relevant to ratings; either very low impact or actively mitigated in a way that results in no impact on the transaction or programme ratings
2	Irrelevant to the transaction or programme ratings; relevant to the sector
1	Irrelevant to the transaction or programme ratings; irrelevant to the sector

Source: Fitch Ratings

ESG Considerations

For each of the programmes considered in the report, Fitch assigned a maximum ESG relevance score of '3'. This means ESG issues are credit neutral or have only a minimal credit impact on the programme, either due to their nature or the way in which they are being managed by the issuer/programme. For more information on our ESG Relevance Scores, visit www.fitchratings.com/esg

Impact of Coronavirus Pandemic on Covered Bonds

Cover Pools Resilient to Pandemic Crisis

We expect the continuing recovery of Australia's economy from the impact of the Covid-19 pandemic to support stable loan performance. The economy was buttressed by government financial support to businesses and consumers as well as payment assistance from lenders. Most mortgage lenders in Australia offered interest deferrals, relief from principal mortgage repayments for up to six months, loan-term extensions and debt consolidation between March 2020 to March 2021 – after which most borrowers have either resumed full repayments or have had their loan terms extended.

A few states were put in lockdown in mid-2021, with some lenders extending assistance until the end of the year. However, this saw a much lower borrower take-up than the offering in 2020. Average assistance across the four programmes peaked at 8.8% of the total outstanding cover pool balance in June 2020, versus less than 1.0% in September 2021.

Stable Performance Outlook

We removed the additional coronavirus stress scenario analysis from our Australian and New Zealand mortgage criteria in March 2021, which had been implemented on 28 July 2020. We believe the stresses contained in the *APAC Residential Mortgage Rating Criteria* are sufficient to account for the uncertainty related to the pandemic, as Australia's recession was shallower than we expected and the health crisis has been largely contained, along with the high vaccination rates.

Limited Impact From Flooding

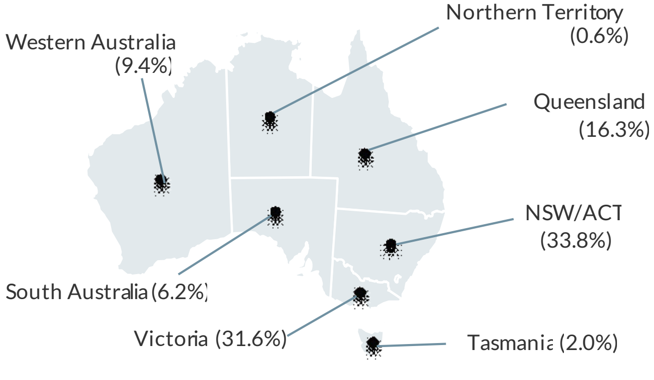
The extent of the impact from the flooding on the east coast of Australia remains unknown, as it can take time for borrowers to assess the damage to their property and contact their bank. However, we expect the flooding to have a limited impact on the cover pools. There is likely to be some increase in 30+ day arrears, but we do not expect a rise in 90+ day arrears. Since loans in 90+ day arrears are not given credit in the ACT calculation, issuers tend to remove these loans from the cover pools. The impact on asset credit risk is further limited by the portfolios' geographical diversification and the fact that the majority of flooded areas were located in less densely populated areas.

Appendix 1A – Focus on ANZ

Programme Structure

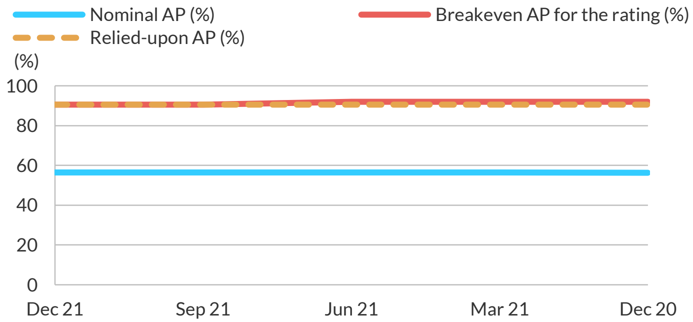
- ANZ can issue covered bonds of up to USD30 billion under its programme.
- The programme features a reserve to mitigate payment interruption, which has been funded when ANZ's Short-Term IDR was downgraded below 'F1+' in April 2020. The reserve is set at the higher of the next three months of interest payments due or three months of accrued interest payments and one quarter of annual senior expenses.
- ANZ has issued both soft and hard-bullet covered bonds. The programme's 12-month PMT has a cure period of 10 days, effectively providing principal liquidity gap protection of up to 12 months should ANZ fail to collateralise the maturities. Hard bullet bonds represented 15.6% of outstanding bonds at end-2021.
- The covered bond guarantor (CBG) has entered into a total return swap to transform the mortgage collections to a one-month (BBSW) plus a margin. ANZ provides covered-bond swaps to hedge currency risk between the Australian dollar assets and foreign currency-denominated covered bonds and interest rate risk for the Australian-dollar bonds. The covered bond swaps in place are forward-starting swaps; this means there will be no exchange of cash flow under the covered bond swaps as long as ANZ acts as swap counterparty and no issuer event of default has occurred.
- We do not give credit to excess OC in the programme, as it is secured by a demand loan whose repayment ranks in priority to covered bond holders upon issuer insolvency. As a result, we rely on the 90.5% contractual AP used in the ACT.

Geographical distribution: (% of residential assets)



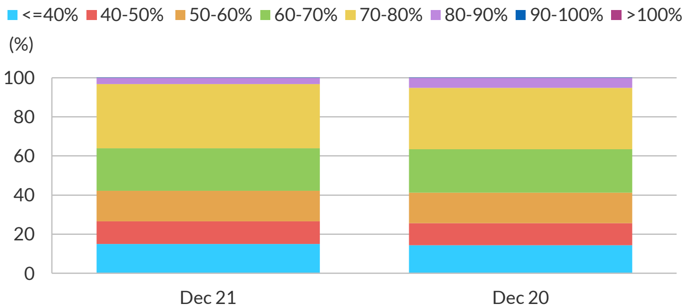
Source: Fitch Ratings, ANZ

Overcollateralisation Breakdown



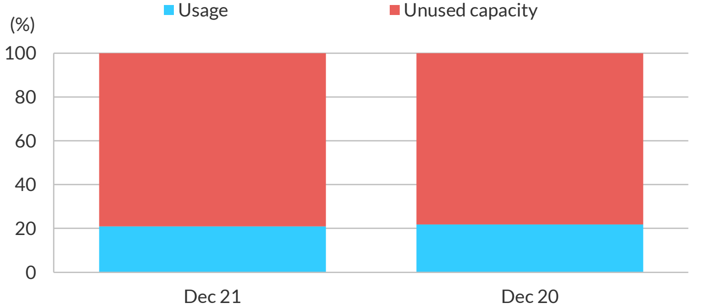
Source: Fitch Rating, ANZ

Consolidated CLTV (% Residential Pool)



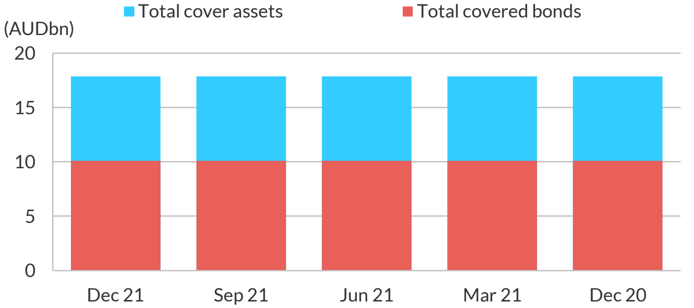
Source: Fitch Ratings, ANZ

Issuance Available Capacity



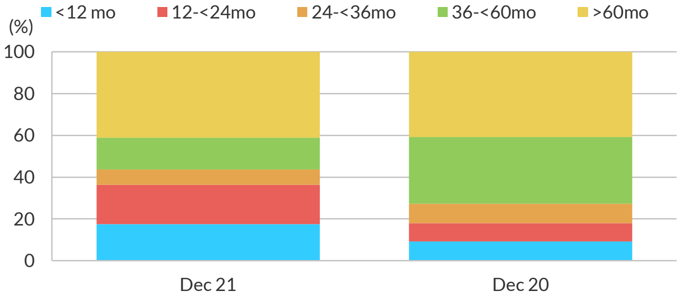
Source: Fitch Ratings; ANZ

Assets and Liabilities



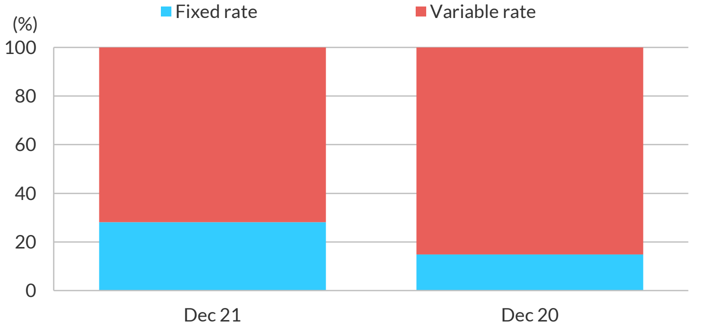
Source: Fitch Ratings, ANZ

Loan Seasoning (% Residential Pool)



Source: Fitch Ratings, ANZ

Loan Payment Type (% Residential Pool)



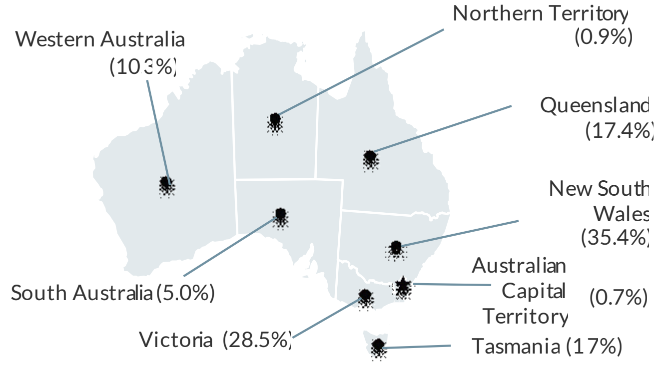
Source: Fitch Ratings; ANZ

Appendix 1B – Focus on CBA

Programme Structure

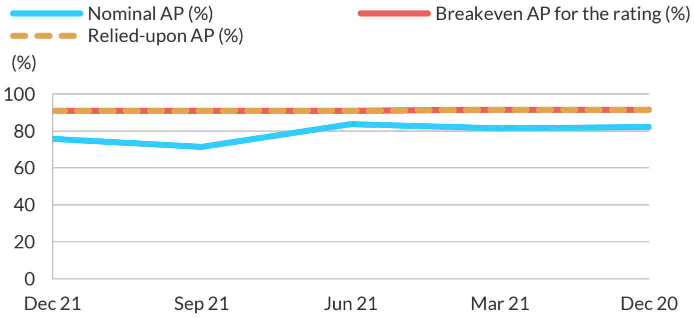
- CBA increased its programme limit from USD30 billion to USD40 billion in 2021.
  The programme features a reserve to mitigate payment interruption, which was funded when CBA's Short-Term IDR was downgraded below 'F1+' in April 2020. The reserve covers three months of swap payments (if a covered bond swap is in place and is provided by a party other than CBA) or three months of interest (if a covered bond swap is not in place and/or is provided by CBA) and three months of senior expenses.
- CBA has issued both soft- and hard-bullet covered bonds. The programme's 12-month PMT has a cure period of six months, which provides for less liquidity gap protection than the up to 12 months of peers. However, we do not think the likelihood of this causing a cross default of the soft bullet bonds is high due to the size (6.3% of outstanding bonds as of end-2021) and distribution of the remaining hard bullet bonds. The 12-month maturity extension drives the PCU assessment, which we consider to be an effective liquidity gap protection for principal payments.
- The CBG has entered into a total return swap to transform the mortgage collections to a one-month BBSW plus a margin. CBA provides covered-bond swaps to hedge currency risk between the Australian dollar assets and foreign currency-denominated covered bonds and interest rate risk for the Australian-dollar bonds. The covered bond swaps in place are not forward-starting swaps.
- We do not give credit to excess OC in the programme, as it is secured by a demand loan whose repayment ranks in priority to covered bond holders upon issuer insolvency. As a result, we rely on the 91.0% contractual AP used in the ACT.

Geographical distribution: (% of residential assets)



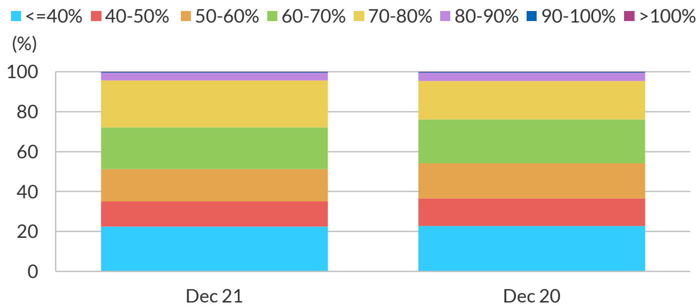
Source: Fitch Ratings, CBA

Overcollateralisation Breakdown



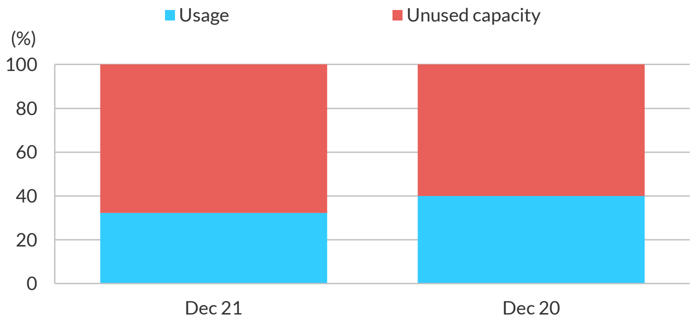
Source: Fitch Rating, CBA

CLTV (% Residential Pool)



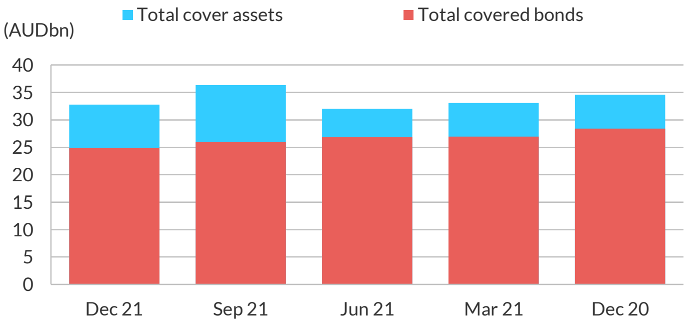
Source: Fitch Ratings, CBA

Issuance Available Capacity



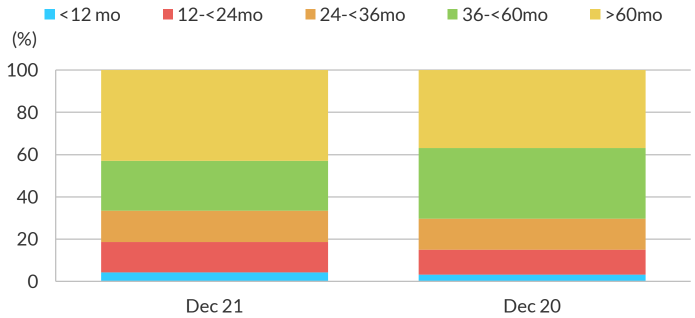
Source: Fitch Ratings; CBA

Assets and Liabilities



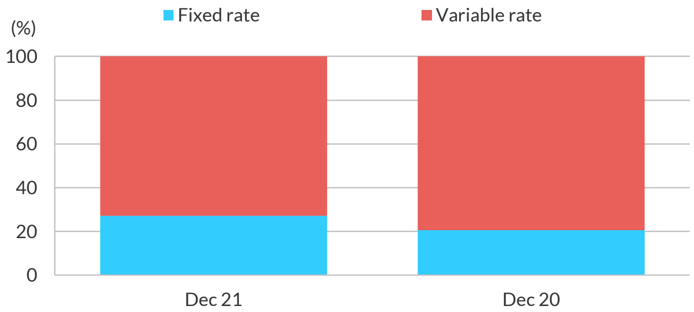
Source: Fitch Ratings, CBA

Loan Seasoning (% Residential Pool)



Source: Fitch Ratings, CBA

Loan Payment Type (% Residential Pool)



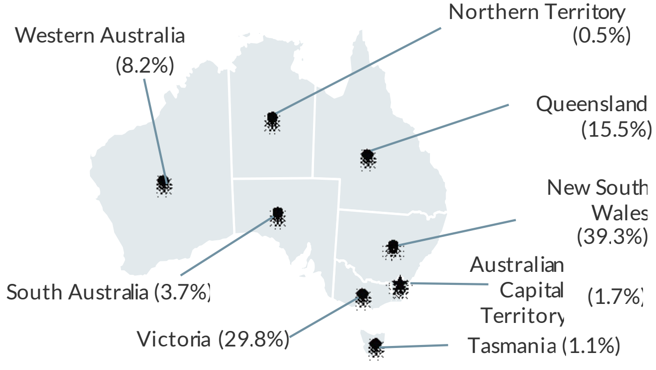
Source: Fitch Ratings; CBA

Appendix 1C – Focus on NAB

Programme Structure

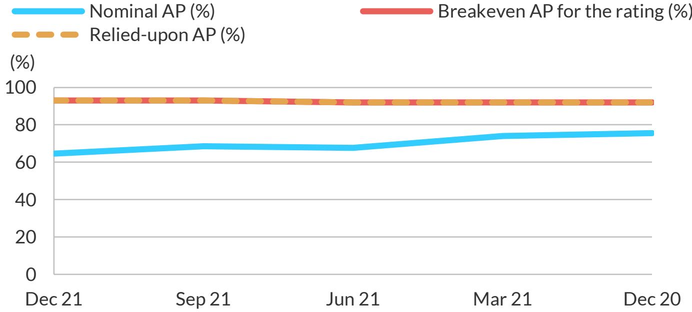
- NAB can issue covered bonds of up to USD30 billion under its programme.
- The programme features a reserve to mitigate payment interruption, which was funded when NAB's Short-Term IDR was downgraded below 'F1+' in April 2020. The reserve covers three months of swap payments (if a covered bond swap is in place and is provided by a party other than NAB) or three months of interest (if a covered bond swap is not in place and/or is provided by NAB) and one quarter of annual senior expenses.
- NAB has issued both soft- and hard-bullet covered bonds. The programme's 12-month PMT has a cure period of 10 days, effectively providing principal liquidity gap protection of up to 12 months should NAB fail to collateralise the maturities. Hard bullet bonds represented 2.8% of outstanding bonds at end-2021.
- The CBG has entered into a total return swap to transform the mortgage collections to a one-month BBSW plus a margin. NAB provides covered-bond swaps to hedge currency risk between the Australian dollar assets and foreign currency-denominated covered bonds and interest rate risk for the Australian-dollar bonds. The covered bond swaps in place are not forward-starting swaps.
- We do not give credit to excess OC in the programme, as it is secured by a demand loan whose repayment ranks in priority to covered bond holders upon issuer insolvency. As a result, we rely on the 91.0% contractual AP used in the ACT.
- The programme does not size for negative carry under the ACT as long as interest-rate swaps on the cover assets are in place.

Geographical distribution: (% of residential assets)



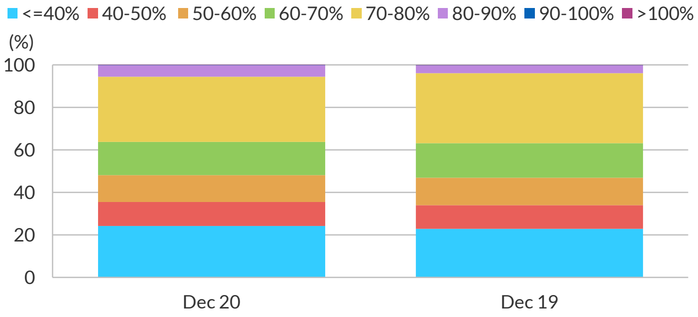
Source: Fitch Ratings, NAB

Overcollateralisation Breakdown



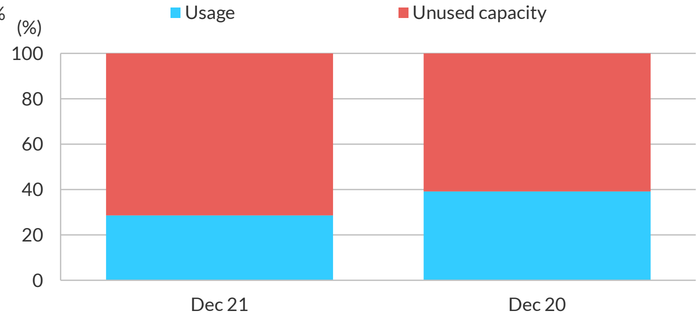
Source: Fitch Rating, NAB

CLTV (% Residential Pool)



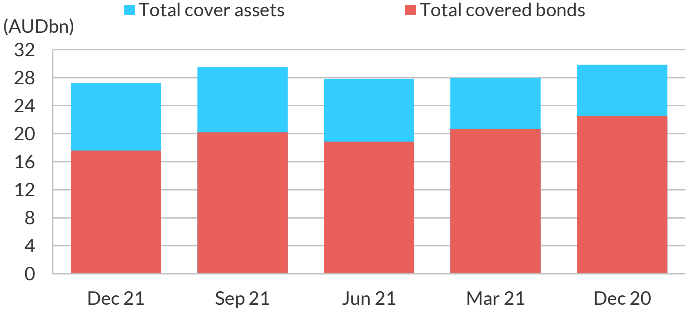
Source: Fitch Ratings, NAB

Issuance Available Capacity



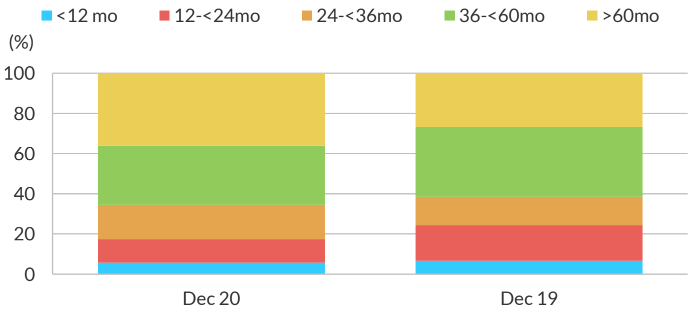
Source: Fitch Ratings; NAB

Assets and Liabilities



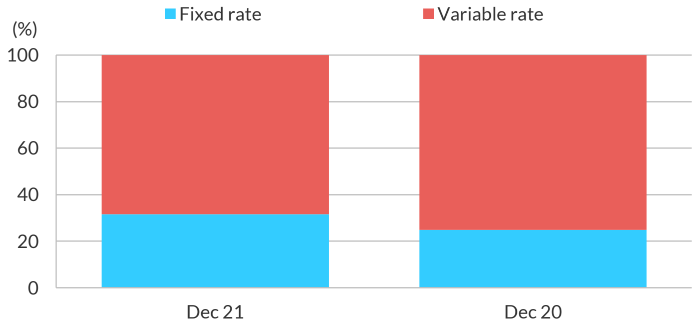
Source: Fitch Ratings, NAB

Loan Seasoning (% Residential Pool)



Source: Fitch Ratings, NAB

Loan Payment Type (% Residential Pool)



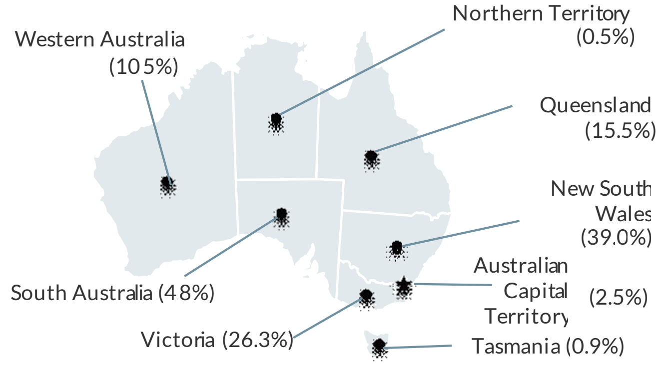
Source: Fitch Ratings; NAB

Appendix 1D– Focus on WBC

Programme Structure

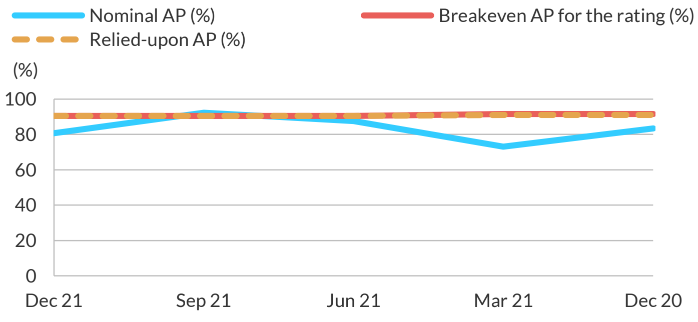
- WBC can issue covered bonds of up to USD40 billion under its programme.
- The programme features a reserve to mitigate payment interruption, which will be funded if WBC's IDRs are downgraded below 'A-' and 'F1'. The reserve is set at the higher of the next three months of interest payments due or three months of accrued interest payments and one quarter of annual senior expenses.
- WBC issues soft-bullet covered bonds that feature a 12-month maturity extension period. The programme also provides for a 12-month pre-maturity test for hard-bullet bond issuance when the Short-Term IDR is below 'F1+'. WBC has only soft-bullet bonds outstanding at present.
- The CBG has entered into a total return swap to transform the mortgage collections to a one-month BBSW plus a margin. WBC provides covered-bond swaps to manage currency risk between the Australian-dollar assets and foreign currency-denominated covered bonds and to manage interest rate risk for the Australian-dollar bonds. The covered bond swaps in place are forward starting. This means there will be no exchange of cash flow under the covered bond swaps as long as WBC acts as swap counterparty and no issuer event of default has occurred.
- We do not give credit to excess OC in the programme, as it is secured by a demand loan whose repayment ranks in priority to covered bond holders upon issuer insolvency. As a result, we rely on the 90.5% contractual AP used in the ACT.

Geographical distribution: (% of residential assets)



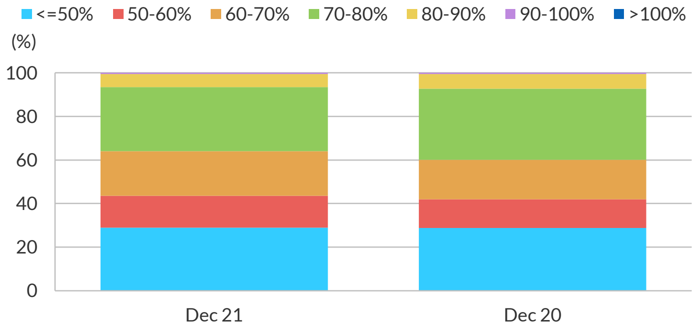
Source: Fitch Ratings, WBC

Overcollateralisation Breakdown



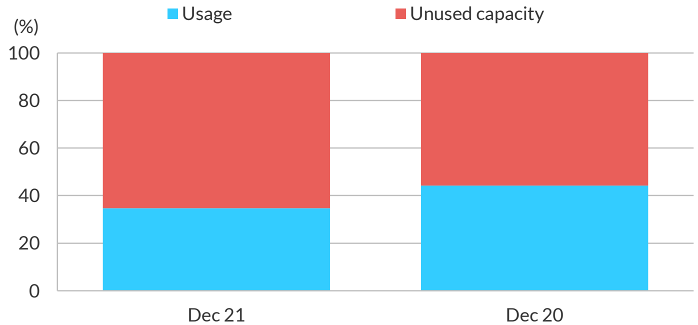
Source: Fitch Rating, WBC

CLTV (% Residential Pool)



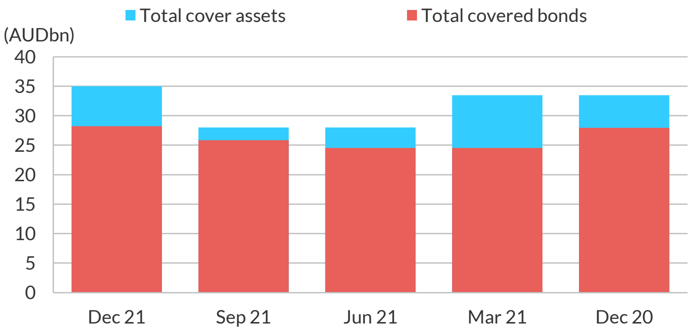
Source: Fitch Ratings, WBC

Issuance Available Capacity



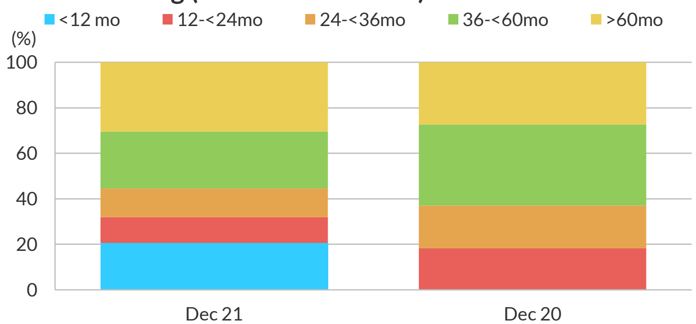
Source: Fitch Ratings; WBC

Assets and Liabilities



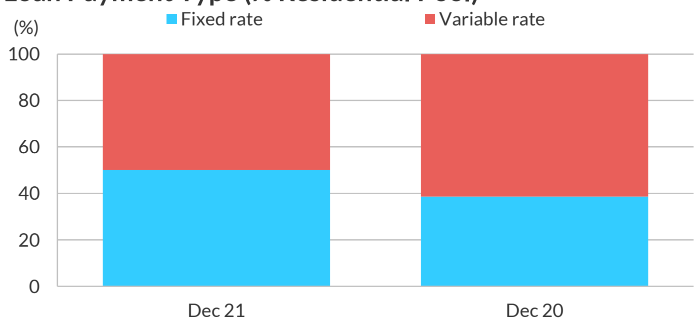
Source: Fitch Ratings, WBC

Loan Seasoning (% Residential Pool)



Source: Fitch Ratings, WBC

Loan Payment Type (% Residential Pool)



Source: Fitch Ratings; WBC

Appendix 2 – Summary of Applicable Covered Bonds Legislation

Items	Description
Basis of the framework	The Banking Act 1959, which was amended in October 2011, permitted the issuance of covered bonds, subject to the encumbrance limit of 8% of an issuer's resident assets in Australia.
Issuer type	Australia-based registered domestic bank or a subsidiary that is guaranteed by such bank. The issuer makes an inter-company loan to the cover pool SPV to enable the SPV to acquire the cover pool and therefore provide a guarantee over the issuer's obligation to bond holders. Upon title perfection, full legal title will be transferred.
Dual recourse	Covered bond holders have recourse to both the general estate of the issuing banks and the cover assets (exclusive right).
Segregation	• SPV model – contractually achieves asset segregation from the issuer's insolvency estate through the true sale of the mortgage assets to the SPV by way of equitable assignment to the CBG. Upon title perfection, full legal title will be transferred. • Asset pool is unavailable to any other creditor of the issuer until the claims of the preferred creditors are met. • Excess cover assets, defined under the legislation as assets not required to repay the covered bonds, will not be available to preferred creditors after issuer insolvency. • Preferred creditors to retain an unsecured claim against the issuer if claims are not fully satisfied from the pool.
Minimum OC	Legal minimum OC is 3% (equivalent to 97.1% AP).
Cover assets	• Loans secured by mortgages, charges or other security interest over residential properties in Australia and the associated LMI policies or other assets. Residential mortgages with LTV ratios of more than 80% can be included in the pool, but the value of the loan is reduced by the amount of excess (above 80% LTV) for the calculation of the 3% legal minimum OC. • Loans secured by mortgages, charges or other security interest over commercial properties in Australia and the associated LMI policies or other assets. Commercial mortgages with an LTV ratio of more than 60% can be included in the pool, but the value of the loan is reduced by the amount of excess (above 60% LTV) for the calculation of the 3% legal minimum OC. • Derivatives held to: (i) protect the value of another asset in the cover pool; (ii) hedge risks related to another asset in the pool; (iii) hedge risks related to covered bonds. • Substitute assets in the form of Australian-dollar deposits, bank bills and certificates of deposit with a maturity of less than 100 days that are not issued by the covered bond issuer are capped at 15% of the covered bonds issued. Bonds, notes or debentures issued by the Commonwealth, a State or a Territory of Australia are also eligible as substitute assets.
Hedging	For all programmes under this report, a total return swap is in place to hedge the interest-rate mismatches on the cover pool. Covered bond swaps are in place to cover currency and interest-rate mismatches on the bonds until the extended due-for-payment date.
Asset coverage test	The ACT is designed to ensure a minimum level of OC on the CVBs to protect bondholders against specific credit and market risks. It is calculated monthly, prior to the service of a notice to pay on the CBG, so long as bonds are outstanding under the programme. The ratio between CVBs and cover assets may not exceed the contractual maximum AP at any time.
Amortisation test	After a service of a notice to pay on the CBG, an amortisation test verifies whether the value of the cover pool, including any cash held in the trust account and any substitute assets, adjusted to account for delinquencies and collateral value, is higher than the notional amount of the outstanding CVBs.
Cap on assets encumbered	No more than 8% of the issuer's total assets in Australia by value can be secured as cover assets.
Supervision	APRA serves as the regulator under the covered bond framework as described in the Banking Act 1959 (amendment 2011). Responsibilities and authority include determining prudential standards in relation to covered bonds and monitoring that reporting requirements are met.
Cover pool administrator	No alternative or dedicated independent manager appointed upon issuer insolvency as an independent corporate service provider is appointed at inception of the administrative CBG. The CBG is obliged to select and sell assets with the assistance of a sales advisor to make repayments of the covered bonds. In the event of a CBG default, the security trustee will enforce the assets for the benefit of covered-bond holders and has the power to appoint a receiver, whose duties are prescribed by the specific programme documents.
Asset monitor	Qualified and licenced audit firm of national standing in Australia to verify the accuracy of the ACT, the amortisation test and the register of cover assets.

Source: Fitch Ratings, banks

Appendix 3 – Related Research & Definitions of Terms Used

Related Research

Details of the programme structures can be found in the following publications:

Australia and New Zealand Banking Group Limited - Mortgage Covered Bonds (September 2019)

Commonwealth Bank of Australia - Mortgage Covered Bonds (November 2019)

National Australia Bank Limited - Mortgage Covered Bonds (October 2019)

Westpac Banking Corporation - Mortgage Covered Bonds (July 2019)

Latest Rating Action

Fitch Rates ANZ's EUR1.75 Billion Series 2022-1 Mortgage Covered Bond 'AAA'; Outlook Stable (March 2022)

Fitch Rates CBA's EUR1.25 Billion Series 91 Mortgage Covered Bonds 'AAA'; Outlook Stable (February 2022)

Fitch Rates NAB's Series 38 EUR1.5 Billion Covered Bonds 'AAA'; Outlook Stable (March 2022)

Fitch Rates Westpac's GBP700 Million Series 2022-C1 Mortgage Covered Bond 'AAA'; Outlook Stable (March 2022)

Related Covered-Bond Specific Research

APAC Covered Bonds Quarterly – 4Q21 (February 2022)

Covered Bonds Surveillance Snapshot – 4Q21 (January 2022)

Covered Bonds Surveillance Snapshot – 4Q21 (Excel) (January 2022)

Fitch Ratings 2022 Outlook: Global Covered Bonds (November 2021)

Global Housing and Mortgage Outlook – 2022 (December 2021)

Covered Bonds in Charts – Demand Loans Enable OC Flexibility Despite Fixed Capacity (October 2021)

Covered Bond Buffer Effective Amid Pandemic (March 2022)

Definitions of Terms Used

ACT	Asset Coverage Test
AP	Asset Percentage
APRA	Australian Prudential Regulation Authority
CBG	Covered Bond Guarantor
CLTV	Current Loan-to-Value
CPT	Conditional Pass Through
CVB	Covered Bonds
DTI	Debt-to-Income
IDR	Issuer Default Rating
LTV	Loan-to-Value
OC	Overcollateralisation
PCU	Payment Continuity Uplift
PD	Probability of Default
PMT	Pre-Maturity Test
WA	Weighted Average
WAL	Weighted Average Life
ANZ	Australia and New Zealand Banking Group Limited
CBA	Commonwealth Bank of Australia
NAB	National Australia Bank Limited
WBC	Westpac Banking Corporation

Source: Fitch Ratings

DISCLAIMER & DISCLOSURES