Australia Mortgage Covered Bond Programmes: Major Banks – Peer Review

Stable Outlook Despite Rising Interest Rates and Inflation

Revised Breakeven AP: Fitch Ratings has revised its 'AAA' breakeven asset percentage (AP) for all Australian covered bond programmes. This was driven by the revised refinancing spread levels (RSLs) for Australian residential mortgages and the removal of the variable rate margin cap of 2% above the bank bill benchmark rate (BBSW). This follows the recent revision of Fitch's *Covered Bonds Ratings Criteria* and *APAC Residential Mortgage Rating Criteria*.

Fixed-Rate Loans Re-Pricing: Australia's cash rate has increased by 3.75pp to 3.85% since May 2022. Fixed-rate loans in the cover pools increased between 2021 and 2022, reflecting the low fixed rates offered by lenders. However, this trend has largely reverted in the last year for the majority of the cover pools (except CBA's).

The average fixed-rate period is one to two years, but can be as long as five years. The majority of the fixed-rate loans in the cover pools have their fixed periods ending in the next 12-18 months, delaying the interest rate impact on borrowers. We expect some borrowers to re-fix their loan rates again to shield them from further interest rate rises and the effects of an increasing cost of living.

Well-Buffered from IDR Downgrade: The 'AAA' covered bond (CVB) ratings can be sustained despite a downgrade of the banks' Long-Term Issuer Default Ratings (IDR) by at least three notches, all else being equal. This is based on the issuing banks' 'A+' IDRs, combined with a total rating uplift of seven notches. The Stable Outlook on the CVBs reflects the buffer against IDR downgrades.

Low Credit Risk Composition: All pools comprise prime Australian residential mortgages, with weighted-average (WA) loan-to-value (LTV) ratios of below 65% and limited adverse loan characteristics. The rating loss rate for all four programmes is floored at the minimum level defined in Fitch's criteria (4.0% at 'AAA') to account for idiosyncratic risks. Cover pool composition for all programmes has been stable over the last 12 months.

Committed AP Used: Fitch disregards the part of the overcollateralisation (OC) between the cover pool and the covered bonds owed by the covered bond guarantor (CBG) 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 AP used in the asset coverage test (ACT).

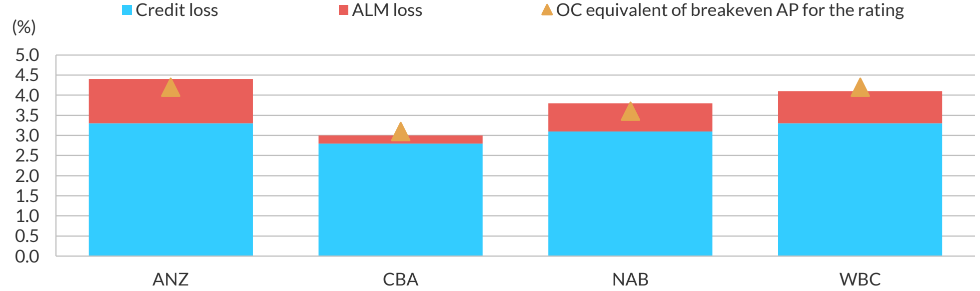
Suppressed Loan Origination: House prices in Australian capital cities have fallen by 9.7% since the peak in April 2022. Low buyer sentiment, rising interest rates and increasing household expenses weigh on new mortgage lending. Mortgage lending volumes fell by 26.3% yoy in March 2023 and we expect this trend to persist while current economic conditions continue.

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 (%)	96.0	97.0	96.5	96.0
AP Fitch relies upon (%)	90.5	95.0	95.0	93.4

As of 30 May 2023.
Source: Fitch Ratings

Breakeven OC for Covered Bonds Rating



Note: The figures are as of 30 May 2023.
Source: Fitch Ratings

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All figures in this report are as of 31 March 2023 unless stated otherwise.

Cover Pool – Peer Analysis

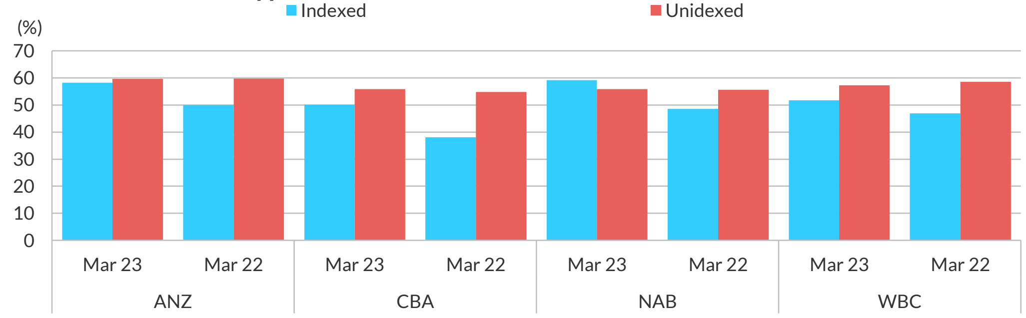
Cover Assets Credit Analysis

	ANZ	CBA	NAB	WBC
Covered bonds rating	AAA	AAA	AAA	AAA
Rating default rate (RDR) for rating (%)	9.7	8.5	10.7	10.5
Rating recovery rate (RRR) for rating (%)	58.9	57.2	64.6	61.8
Rating loss rate (RDR*(1-RRR)) for rating (%)	4.0	3.6	3.8	4.0
'B' case loss rate (%)	0.4	0.4	0.4	0.4

Source: Fitch Ratings

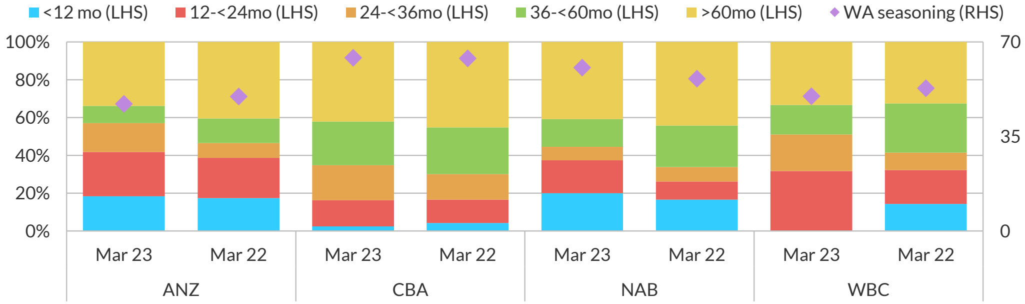
- All cover pools comprise first-ranking prime residential mortgage loans denominated in Australian dollars and backed by residential properties in Australia. The average 'B' portfolio loss rate for the four cover pools is 0.4%, which has remained mostly stable.
- CBA's cover pool has the strongest credit characteristics, with the lowest LTVs and low levels of interest-only and investment loans. It also has the highest proportion of loans with lenders' mortgage insurance (LMI), which have contributed to a low rating loss rate.
- Pre-credit to LMI, the rating loss rate for all four 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 of 10.7% and 10.5%, respectively, driven by adverse credit characteristics. These include more loans with higher WA LTV ratios, particularly LTVs above 80%, and a greater share 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.
- Portions of loans with interest-only periods have been falling in the cover pools (except ANZ) over the last 12 months, as interest-only terms ended and the loans began to amortise over the remaining mortgage terms. Meanwhile, the proportion of fixed-rate loans has decreased (except CBA). The interest rates of fixed-rate loans now on offer are higher than those for variable-rate loans, so some borrowers that were previously on fixed rates opted to convert their loans to variable rate after the fixed periods ended.
- Australia's cash rate has increased by 3.75pp since May 2022. Despite this, the cover pools' arrears rates remained low, with 30+ day arrears across the four programmes ranging from 0.2% to 0.5% at end-March 2023. Loans that are 90+ days past due are not given credit in the ACT calculation, so issuers tend to remove these loans from the pool.

Loan to Value Ratio Type



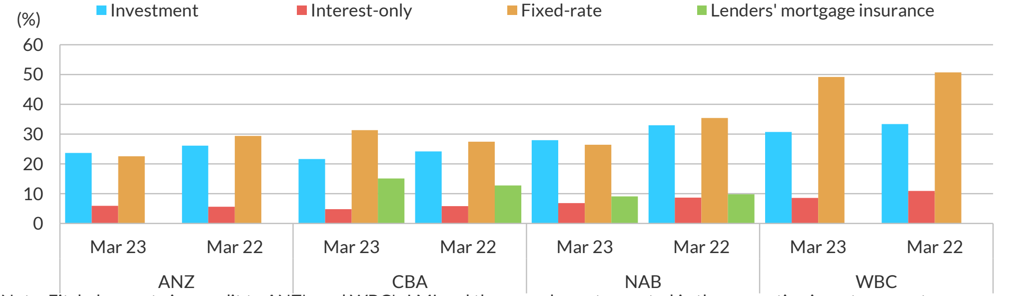
Source: Fitch Ratings, ANZ, CBA, NAB, WBC

Loan Seasoning (% of Residential Pool)



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

Loan Type (% of Pool)



Note: Fitch does not give credit to ANZ's and WBC's LMI and they are also not reported in the respective investor reports.
Source: Fitch Ratings, ANZ, CBA, NAB, WBC

Breakeven OC – Peer Analysis

Breakeven OC Components for the Ratings

Programme	ALM loss (%)	Credit loss (%)
ANZ	1.1	3.3
CBA	0.2	2.8
NAB	0.7	3.1
WBC	0.8	3.3

Note: As of 30 May 2023.
Source: Fitch Ratings

Credit Loss

- The credit loss component now drives Fitch's 'AAA' breakeven OC. It reflects the stressed credit loss derived by Fitch under its analysis of each cover pool of the four programmes at the 'AA+' timely payment rating level. The credit loss for all pools is low due to strong credit quality and is floored at the minimum level defined in Fitch's criteria (pre-LMI). CBA has the lowest credit loss as its cover pool has the highest proportion of loans with LMI.

ALM Loss

- The ALM loss component represents modelled asset and liability mismatches, inclusive of modelled excess spread. This considers the effect of the sales constraint that restricts the assets that can be sold to the pro rata proportion of the bond redemption.
- All programmes' ALM loss components reduced in the last 12 months on the implementation of updated criteria. The updates led to increased credit to excess spread from variable-rate assets and reduced applicable RSLs for Australian residential mortgages to 150bp, from 234bp, at the 'AA+' timely payment rating stress level.
- At the time of the last cash flow modelling, CBA had the highest modelled excess spread than peers. For all programmes (except CBA), the ALM loss components are affected by concentrated bond maturities in the liability profile at the last analysis.
- About AUD8.1 billion, or over 60% of ANZ's outstanding bonds, will mature in the 12 months from November 2024. For NAB, AUD7.7 billion will fall due in the 12 months from December 2025. For WBC, AUD8.6 billion will be due in 2025, AUD4.5 billion of which will mature in January 2025, the largest redemption in a single month of the four programmes.
- Maturity concentration creates the need to sell more cover assets in our modelling and negatively affects the programmes' pro rata sales constraint, because it allows only the pro rata proportion of assets to be sold for the liabilities redeemed. Therefore, a higher level of OC is needed to meet the required sale amount and not trigger the pro rata sale constraint.

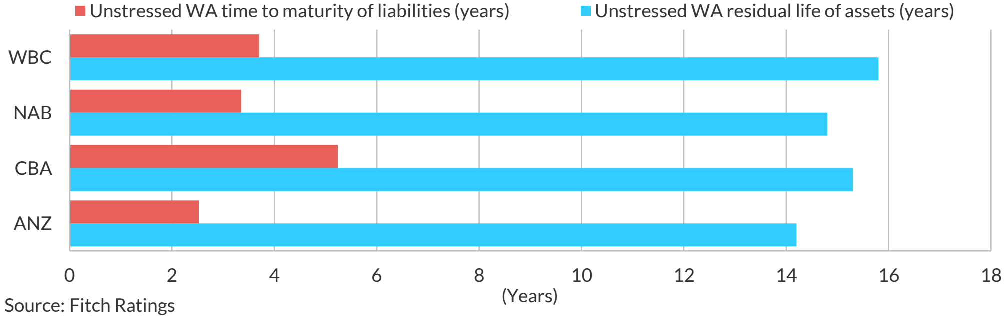
Cash Flow Analysis Driving Scenarios

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

Source: Fitch Ratings

Unstressed Assets & Liabilities Maturity Mismatches

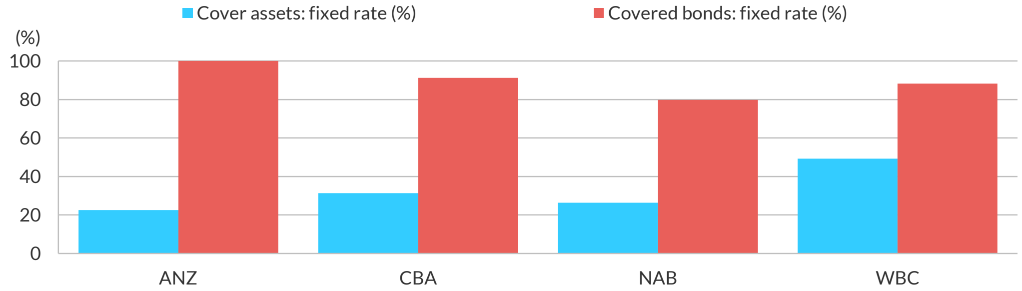
At 31 March 2023



Source: Fitch Ratings

Pre-Swap Fixed-Rate Assets and Liabilities Interest-Rate Mismatches

At 31 March 2023



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

- 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, which are domestic systemically important banks, must hold 3% 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 current assessment is based on the 12-month maturity extension on the outstanding soft bullet bonds for all four programmes.
- CBA's pre-maturity test (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 4.4% of CBA's outstanding covered bonds and 2.1% of NAB's at 31 March 2023.
- 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.

Recovery Uplift Assessment

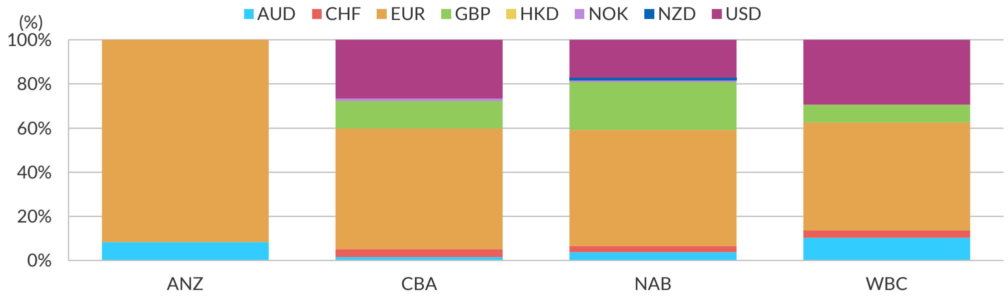
Programme	'AAA' credit loss (%)	OC Fitch relies on in its analysis (%)	Pre-swap foreign-currency bond exposure (%)	Maximum achievable recovery uplift (notches)
ANZ	4.2	10.5	93.6	1
CBA	3.8	5.3	98.4	1
NAB	4.0	5.3	96.3	1
WBC	4.2	7.1	89.8	1

Source: Fitch Ratings

Recovery Uplift

- The cover assets are standard Australian residential mortgage loans.
- The recovery uplift is capped at one notch for all programmes due to the presence of material pre-swap currency mismatches between the cover assets and liabilities. The cover assets are denominated in Australian dollars, while the CVBs are mostly denominated in other currencies, mainly euros (see chart below).
- Swaps are in place to hedge the non-Australian dollar CVBs, but we expect the swaps to terminate upon a CVB default. This could expose non-Australian dollar bondholders to foreign-exchange risk, as recoveries come from the Australian dollar assets, which have a longer WA life than the CVBs.

Covered Bonds by Currency (End-March 2023)



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

ESG Considerations

ESG Relevance Scores Recap

		ANZ	CBA	NAB	WBC
Environmental (E)	GHG emissions & air quality	1	2	2	2
	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

An ESG.RS of '2' is applicable to the GHG Emissions & Air Quality general issue for all CVBs secured by portfolios of residential assets across EMEA, Australia and Singapore. This is an increase from a score of '1' and reflects an increased focus on emissions and wider energy efficiency considerations across the residential housing sector, making this general issue relevant to the sector as a whole. Fitch will revise the score during the course of their standard annual review and for ANZ, the annual review has not been performed since the change of score in February 2023.

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

Credit-Relevant ESG Scale Definitions

How relevant are E, S and G issues to the overall credit rating?	
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

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

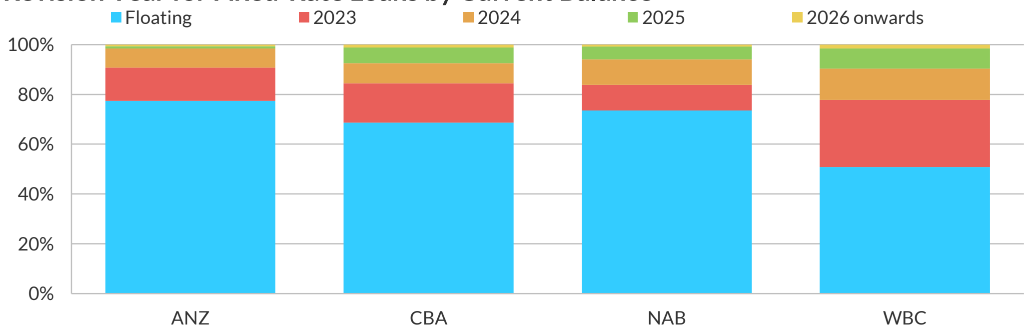
Impact of Rising Cost of Living on the Covered Bonds

Cover Pools Resilient to Rate Hikes

The Reserve Bank of Australia raised its policy rate to 3.85% in May 2023, from 0.1% in May 2022, to combat inflation. Borrowers on floating-rate mortgages or those reaching the end of their fixed-rate terms are likely to be most affected by rising interest rates and inflation. Although borrower serviceability is assessed with a buffer at a stressed interest rate, for a sizeable portion of the loans, interest rates have risen above the buffer and, as a result, arrears in the portfolio will increase.

However, we expect the deterioration in performance for the loans in the mortgage cover pools to be limited because Fitch expects unemployment to remain low and wage growth to continue. In addition, contractual provisions, like a maximum indexed LTV limit of 80% and no credit for non-performing loans in the ACT, safeguard the credit quality of the cover pools. Finally, the low indexed LTVs of the cover pools provide significant buffer against house price declines.

Revision Year for Fixed-Rate Loans by Current Balance



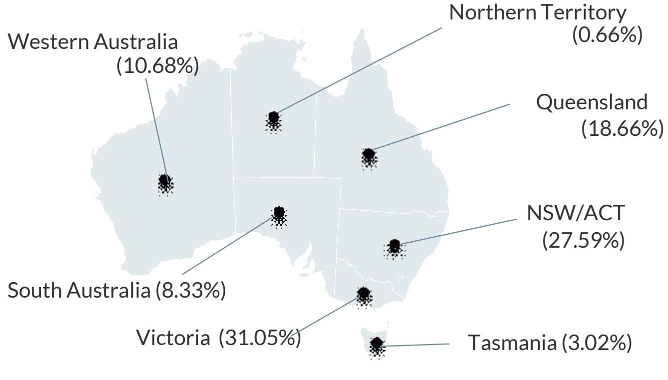
Source: Fitch Ratings, ANZ, CBA, NAB, WBC

Appendix 1A – Focus on ANZ

Programme Structure

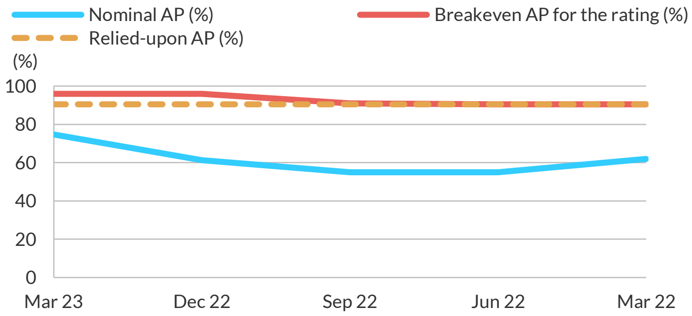
- ANZ can issue covered bonds of up to USD30 billion under its programme.
- The programme features a reserve to mitigate payment interruption, which was funded when ANZ's Short-Term IDR was downgraded below 'F1+' in April 2020. The reserve is set at the higher of the next three months of interest payments 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. ANZ's last hard bullet bond matured in July 2022.
- The 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)



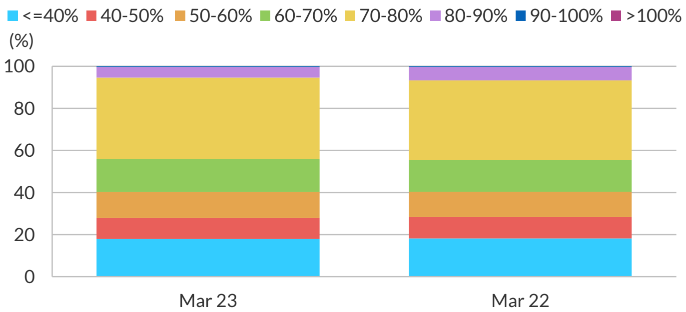
Source: Fitch Ratings, ANZ

Overcollateralisation Breakdown



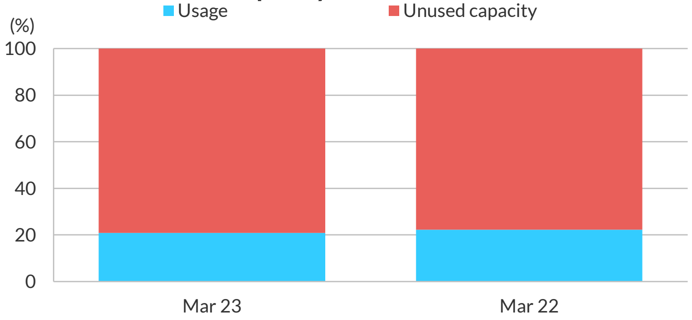
Source: Fitch Rating, ANZ

Consolidated CLTV (% Residential Pool)



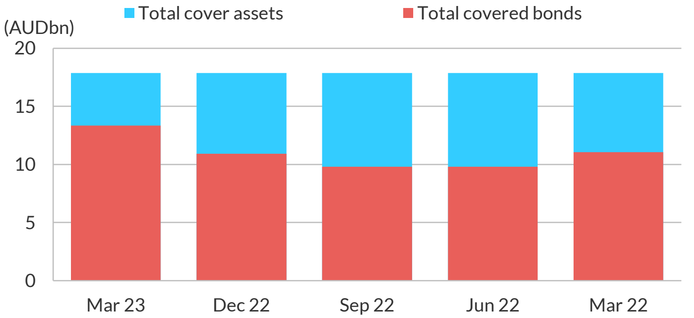
Source: Fitch Ratings, ANZ

Issuance Available Capacity



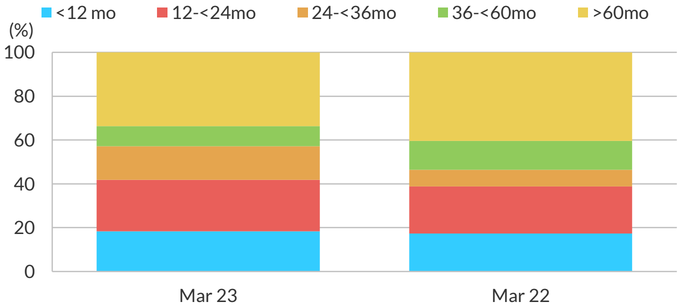
Source: Fitch Ratings; ANZ

Assets and Liabilities



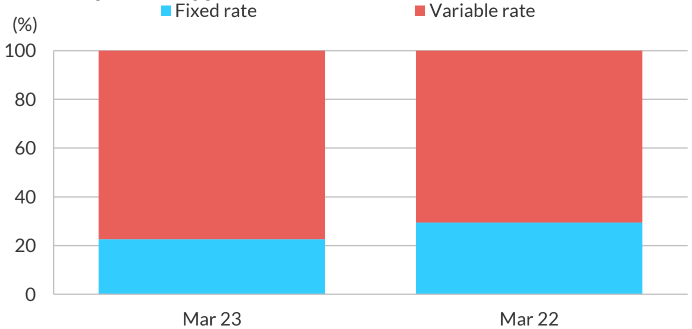
Source: Fitch Ratings, ANZ

Loan Seasoning (% Residential Pool)



Source: Fitch Ratings, ANZ

Loan Payment Type (% Residential Pool)



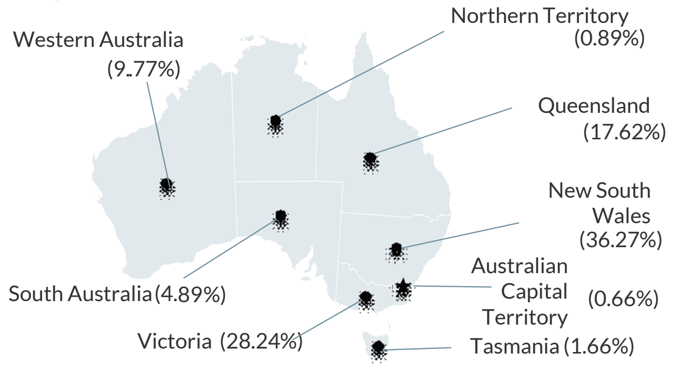
Source: Fitch Ratings; ANZ

Appendix 1B – Focus on CBA

Programme Structure

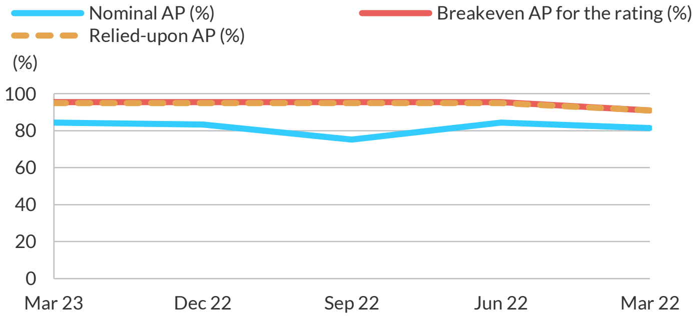
- CBA can issue covered bonds of up to USD40 billion under its programme.
- The programme features a reserve to mitigate payment interruption, which was funded when CBA's Short-Term IDR was downgraded below 'F1+' in April 2020. The reserve covers three months of swap payments (if a covered bond swap 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 (4.4% of outstanding bonds as of 31 March 2023) 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 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 95.0% contractual AP used in the ACT.

Geographical distribution: (% of residential assets)



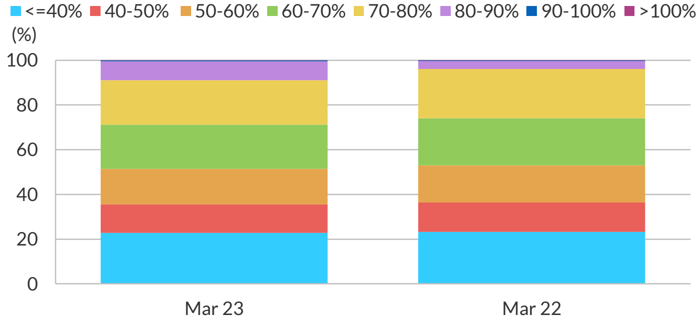
Source: Fitch Ratings, CBA

Overcollateralisation Breakdown



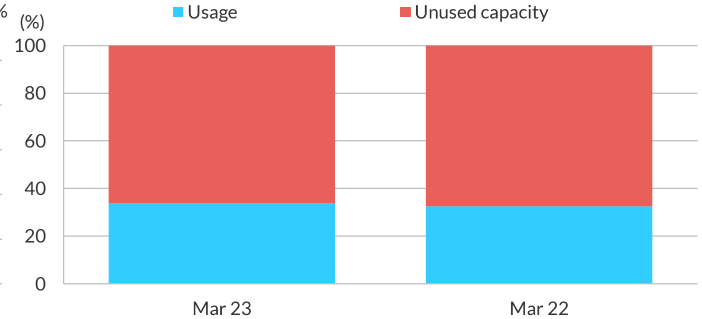
Source: Fitch Rating, CBA

CLTV (% Residential Pool)



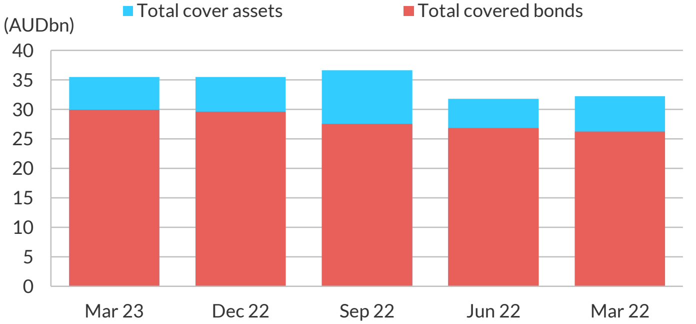
Source: Fitch Ratings, CBA

Issuance Available Capacity



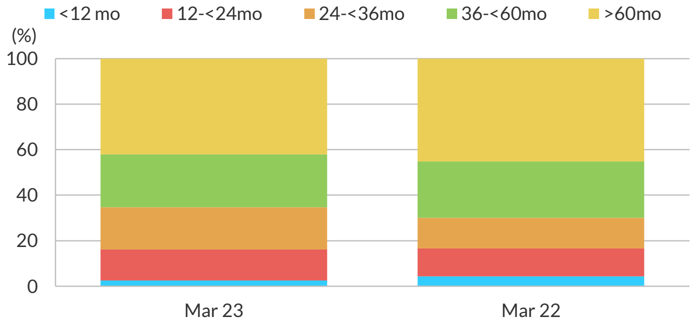
Source: Fitch Ratings; CBA

Assets and Liabilities



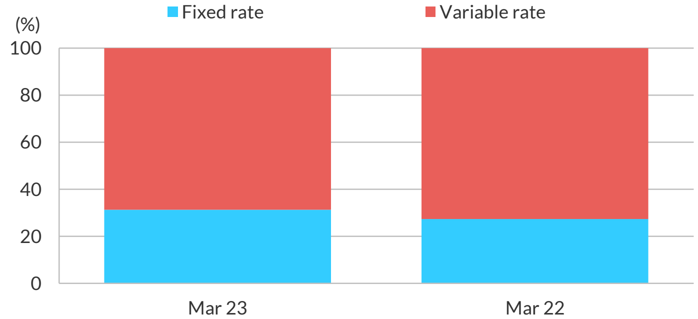
Source: Fitch Ratings, CBA

Loan Seasoning (% Residential Pool)



Source: Fitch Ratings, CBA

Loan Payment Type (% Residential Pool)



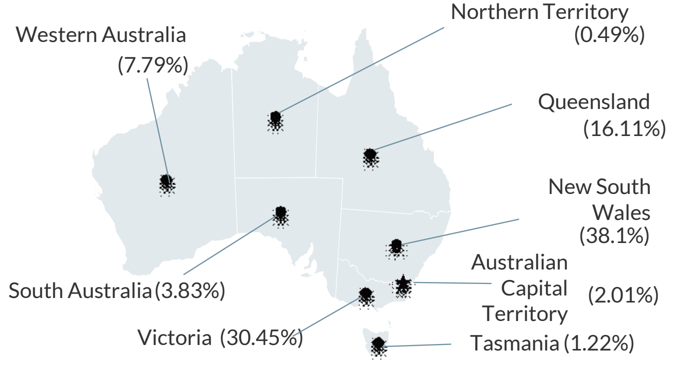
Source: Fitch Ratings; CBA

Appendix 1C – Focus on NAB

Programme Structure

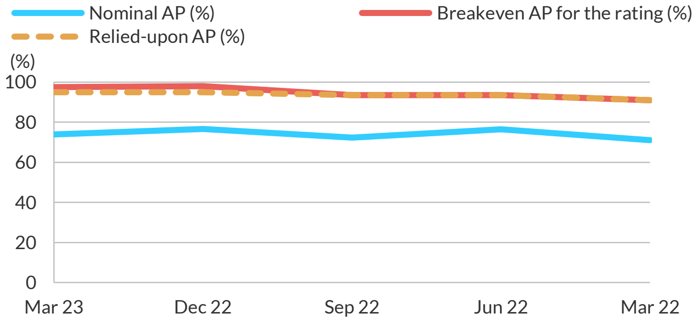
- NAB can issue covered bonds of up to USD30 billion under its programme.
- The programme features a reserve to mitigate payment interruption, which was funded when NAB's Short-Term IDR was downgraded below 'F1+' in April 2020. The reserve covers three months of swap payments (if a covered bond swap 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 2.1% of outstanding bonds at 31 March 2023.
- 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 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 95.0% 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)



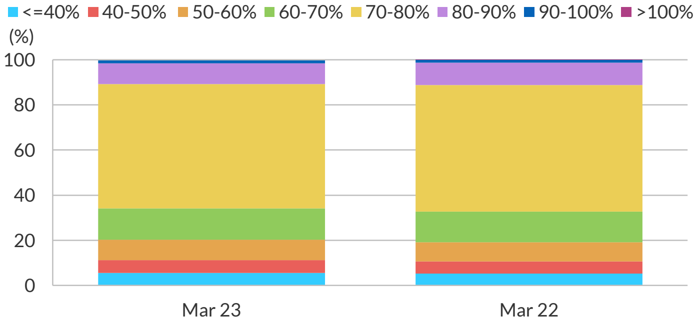
Source: Fitch Ratings, NAB

Overcollateralisation Breakdown



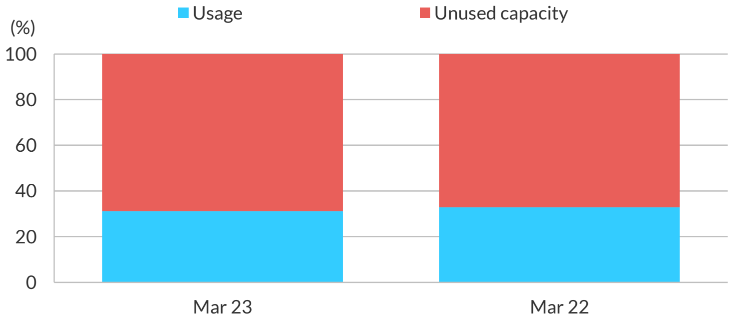
Source: Fitch Rating, NAB

CLTV (% Residential Pool)



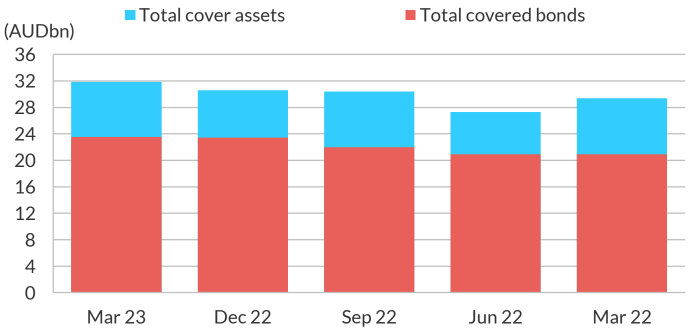
Source: Fitch Ratings, NAB

Issuance Available Capacity



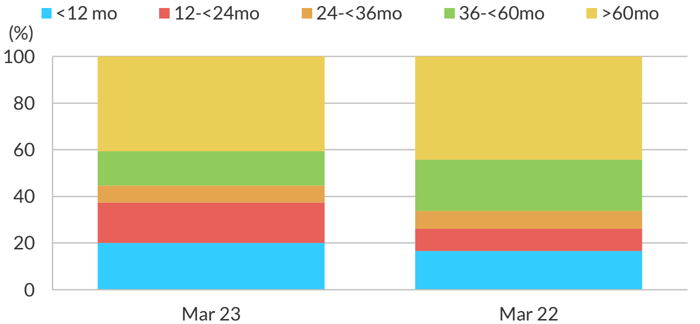
Source: Fitch Ratings; NAB

Assets and Liabilities



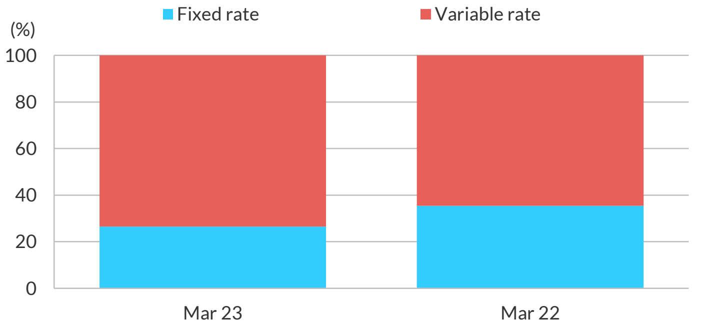
Source: Fitch Ratings, NAB

Loan Seasoning (% Residential Pool)



Source: Fitch Ratings, NAB

Loan Payment Type (% Residential Pool)



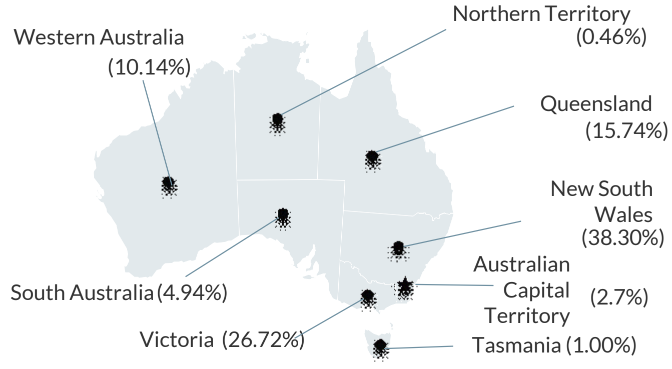
Source: Fitch Ratings; NAB

Appendix 1D– Focus on WBC

Programme Structure

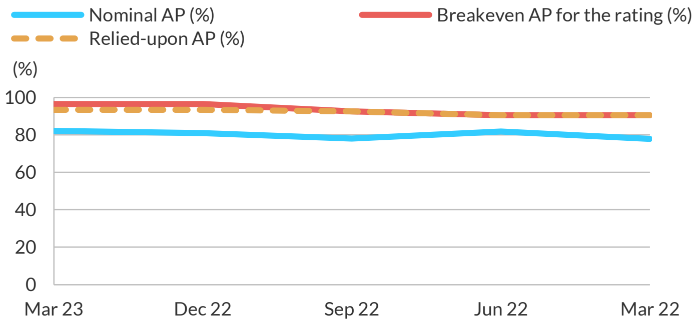
- WBC can issue covered bonds of up to USD40 billion under its programme.
- The programme features a reserve to mitigate payment interruption, which will be funded if WBC's IDRs are downgraded below 'A-' and 'F1'. The reserve is set at the higher of the next three months of interest payments due or three 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 PMT 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 are forward starting. This means there will be no exchange of cash flow under the 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 93.4% contractual AP used in the ACT.

Geographical distribution: (% of residential assets)



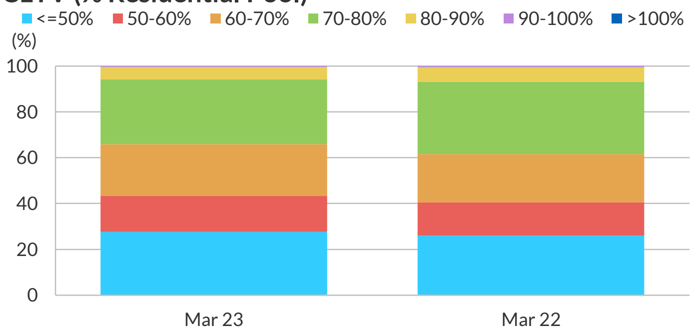
Source: Fitch Ratings, WBC

Overcollateralisation Breakdown



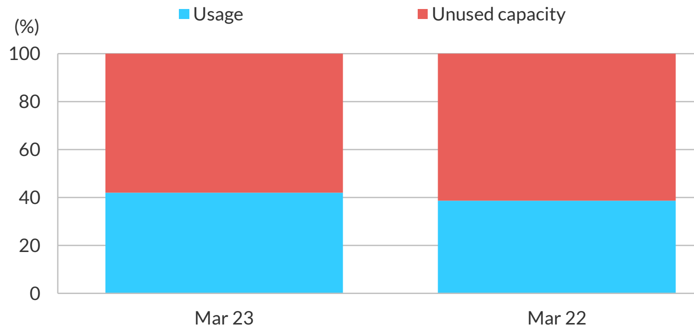
Source: Fitch Rating, WBC

CLTV (% Residential Pool)



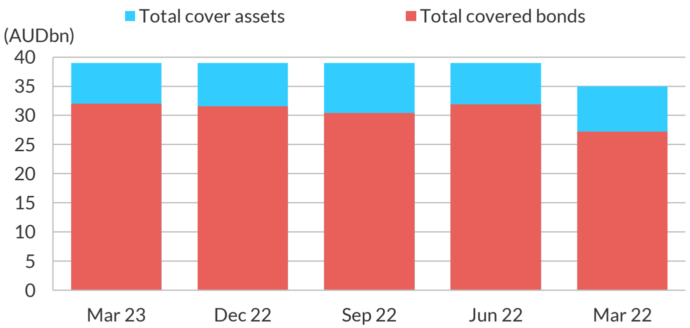
Source: Fitch Ratings, WBC

Issuance Available Capacity



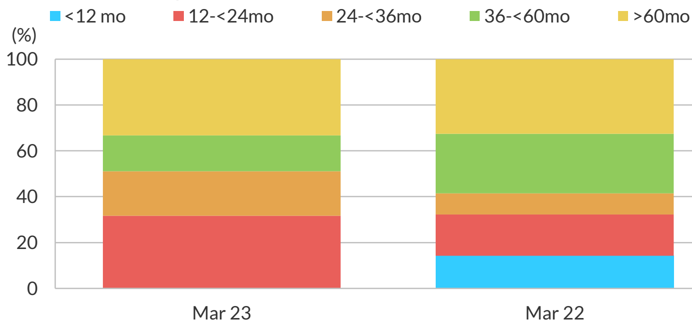
Source: Fitch Ratings; WBC

Assets and Liabilities



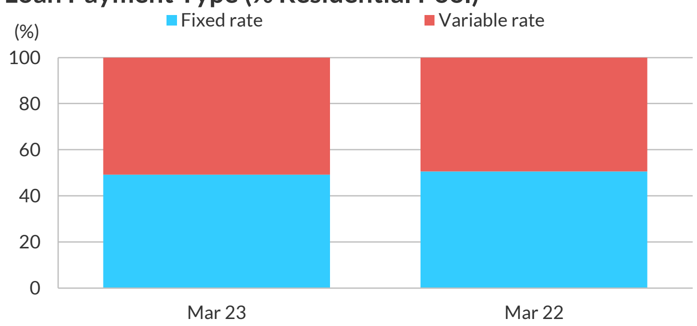
Source: Fitch Ratings, WBC

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 Series 2023-1 EUR1.5 Billion Mortgage Covered Bonds 'AAA'; Outlook Stable (April 2023)

Fitch Affirms CBA's Mortgage Covered Bonds at 'AAA'; Outlook Stable (May 2023)

Fitch Rates NAB's Series 44 GBP1.25 Billion Covered Bonds 'AAA'; Outlook Stable (May 2023)

Fitch Rates Westpac's USD1.75bn Series 2023-C3 Mortgage Covered Bond 'AAA'; Outlook Stable (May 2023)

Related Covered-Bond Specific Research

APAC Covered Bonds Quarterly – 4Q22 (February 2023)
Covered Bonds Snapshot – 1Q23 (April 2023)
Covered Bonds Snapshot Data – 1Q23 Excel (April 2023)
Global Covered Bonds Outlook 2023 (December 2022)
Global Housing and Mortgage Outlook – 2023 (December 2022)
Australia and New Zealand Structured Finance Outlook 2023 (November 2022)
Global Mortgage Markets Ranked by Vulnerability to Rising Rates (May 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