



8 April 2009

To All Authorised Deposit-taking Institutions

SECURITISATION AND FUNDS MANAGEMENT

Since the introduction of the revised Prudential Standard *APS 120 Securitisation* in January 2008, authorised deposit-taking institutions (ADIs) have approached APRA with various requests relating to their outstanding securitisations and compliance with the standard, as well as to their involvement with funds management activities. This letter outlines the application of particular APS 120 requirements, and funds management matters, which have been the subject of these enquiries.

APS 120 Securitisation

Acquisition of Exposures or Securities

A number of ADIs have sought APRA's approval to repurchase assets from pools they originated, despite the value of the pool not having been amortised to the level required in APS 120 Attachment F paragraph 3(c), claiming that the securitisations are no longer economical for them to maintain. Originating ADIs must adhere to the 10 per cent clean-up call threshold for all securitisations, including those that were established prior to the revised standard coming into effect on 1 January 2008. There is no discretion in the standard for APRA to approve asset purchases beyond this threshold.

APRA has also been approached by ADIs seeking to purchase all outstanding securities issued by structures for which they are the originating ADI, as an alternative to purchasing the assets directly. Paragraph 8(c) in APS 120 Attachment F limits holdings of securities by originating ADIs to less than 20 per cent of the value of securities outstanding. As is the case with the asset purchase restrictions, APS 120 does not allow for case-by-case approvals of holdings of securities in excess of the prudential limit.

Self-Assessments

In accordance with APS 120 paragraph 18, APRA expects that ADIs have undertaken written assessments of each securitisation in which they participate and that such assessments are submitted to APRA upon request. ADIs should note that this requirement extends to all levels of involvement in securitisation, not just to participation by entities meeting the definition of an originating ADI. Furthermore, these self-assessments must be available for all outstanding securitisations, not just those entered into following the release of the revised APS 120.

APRA reiterates the guidance on self-assessment found in APG 120 paragraphs 5-10. ADIs need to consider each relevant requirement in APS 120 individually, and set out references to supporting documentation, policies and procedures and opinions, in documenting their assessments. It is insufficient to rely upon verbal assurances, operational understandings or other undocumented information when ADIs undertake their assessments of compliance with APS 120. Furthermore, APRA expects each assessment to describe the capital methodology used for the exposures related to the securitisation.

A mechanistic legal approach to assessing compliance of a securitisation is unlikely to satisfy APG 120's requirements; business judgement must augment legal assessment. Assessments are to be undertaken by staff with a detailed understanding of each specific transaction and its position within the broader securitisation structure, and signed off by senior staff from the ADI's securitisation and legal, compliance or risk management areas.

Transitional Relief

APRA reminds ADIs that have been granted transitional relief under APS 120 that they have until 30 June 2010 to rectify the areas of non-compliance for which they were granted relief. Further transitional relief beyond this date will not be granted. APRA expects that ADIs have made significant progress towards ensuring they meet this deadline and that, with the exception of breaches that were granted transitional relief, all other participation in securitisation by ADIs is now compliant with APS 120.

Maximum Capital Amount

The election under APS 120 Attachment B paragraph 23 permits an ADI to risk weight the underlying exposures in a securitisation for capital purposes rather than apply the securitisation rules. This provision was designed to cap the regulatory capital required for securitised assets in accordance with the Basel II Framework. It was not intended as a mechanism for ADIs to issue non-complying securitisation transactions or to take on additional risks via securitisation that are not inherent in the underlying assets.

As a result, APRA expects that ADIs will in future seek APRA approval to use the election under APS 120 Attachment B paragraph 23 for any new securitisation transactions that do not meet all requirements of APS 120. Such approval will not be forthcoming where the structure appears designed primarily to obtain funding in a manner that circumvents the Banking Act's depositor protection provisions. In addition, even where this election is applied, APRA may require regulatory capital to be held against any further risks or other support within these transactions (such as market risk or yield enhancement) to be deducted from the ADI's Tier 1 capital. APRA will consider removing the election option from APS 120 if evidence arises that it is being used inappropriately.

Funds Management

When the revised APS 120 standard, which focuses on securitisation, was introduced, APRA indicated that ADIs were to continue to comply with the funds management requirements in the previous Prudential Standard *APS 120 Funds Management and Securitisation* (May 2006). This is an interim arrangement until a new prudential standard for funds management is released in 2010.

It is paramount that separation exists between ADIs and their related funds management schemes. An ADI's involvement in such schemes must be accompanied by clear and prominent disclosures to investors of the limitations of its obligations. All undertakings given by an ADI must be subject to the ADI's usual approval and control processes, expressed clearly in legal documentation, and fixed as to time and amount.

ADIs must deal with funds management vehicles and/or investors at arm's length and on market terms and conditions. As is the case with securitisation, purchases of assets and securities from funds management vehicles are limited to prescribed levels, as stipulated in AGN 120.3.

If you have any questions regarding these matters, please contact your APRA Responsible Supervisor.

Yours sincerely

A handwritten signature in black ink, appearing to read 'Charles Littrell', written in a cursive style.

Charles Littrell
Executive General Manager
Policy, Research and Statistics