



Australian discretions for the internal ratings-based (IRB) approach to credit risk and securitisation

Basel II June 2004 Framework paragraph reference	Summary of the Basel II Framework discretion	APRA's proposed approach
Transitional provisions and permanent exemptions		
257	Allow a phased rollout of an IRB approach across an ADI consolidated banking group	Yes – on a case-by-case assessment
259	Exempt ADIs from the requirement to adopt IRB for some exposures in business units that are immaterial in terms of size and perceived risk profile	Yes – on a case-by-case assessment
Foundation IRB approach discretions		
288	Apply a wider definition of subordination	No
318	Use of an explicit or implicit maturity adjustment	Explicit maturity adjustment
521	Recognition of the credit risk mitigating effect of additional forms of physical collateral	No
IRB corporate discretions		
274	Base the firm-size adjustment for SME exposures on total assets rather than total sales	Yes – with ADIs required to have policies on exposures where total assets, rather than total sales, is a more appropriate basis for the SME firm-size adjustment
IRB retail discretions		
231	For residential mortgage exposures, define a threshold for the number of housing units included as collateral	No
232	Define a threshold for the number of exposures within a pool for a pool to be treated as retail	No
467	Require a mandatory upwards adjustment of probability of default estimates to reflect anticipated seasoning effects	No
IRB equity discretions		
Footnote 59 to paragraph 237	Allow debts with the economic substance of equity not to be treated as equity where they are directly hedged by an equity holding such that the net position does not involve material (equity) risk	Yes – on a case by case basis with APRA approval
238	Re-characterise certain debt holdings as equities for regulatory purposes	Yes – debt obligations and other securities, derivatives or other instruments structured with the intent of conveying the economic substance of equity should be considered equity exposures for IRB purposes

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341	Approach for risk-weighting equity exposures held in the banking book	The simple risk-weight (market based) approach will be adopted. The same risk-weights for publicly traded and other equities held in the banking book will be adopted in the standardised approach to credit risk
356	Allow equity holdings in entities whose debt obligations qualify for a zero risk-weight under the standardised approach to be excluded from IRB (equity) treatment	n.a.
357	Allow equity holdings made under legislated programs to be excluded from IRB (equity) treatment	n.a.
358	Exclusion of equity exposures of an ADI from IRB treatment based on materiality	n.a.
260	Require ADIs with significant equity exposures to adopt an IRB approach to equity even though the ADI may not employ an IRB approach in other business lines	n.a.
267	For a maximum of ten years, exempt from IRB treatment particular equity investments held at the time of the publication of the Framework	n.a.
Purchased receivables		
242	Establishment of a concentration limit for purchased corporate receivables above which ADIs must calculate the capital charge for default risk on the bottom-up approach	Yes – \$100,000 concentration limit
Footnote 78 to paragraph 373	Recognise guarantors that are internally rated and associated with a probability of default equivalent to less than A- under the foundation IRB approach for purposes of determining the capital requirement for dilution risk	Yes
IRB maturity adjustment		
319	Allow smaller domestic firms with sales and assets less than €500 million to be exempt from the calculation of an explicit maturity adjustment	No

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321	Determine which instruments will be eligible for the carve-out from the one year maturity floor	APRA will allow the short-term exposures listed in paragraph 322 of the Framework to be eligible for the carve-out from the one year maturity floor
Risk quantification		
Footnote 82 to paragraph 452	Set the number of days past due to trigger default for retail exposures and exposures to public sector entities beyond 90 days	No
458	Apply more specific re-aging requirements	No
Corporate governance and oversight		
443	Require an external audit of ADIs' rating assignment processes and estimation of loss characteristics	No
Rating system design		
404	Require ADIs to establish a greater number of borrower grades than seven for non-defaulted borrowers and one for defaulted borrowers	No
Securitisation		
582 and 641	Allow undrawn servicer cash advances that are unconditionally cancellable without prior notice to be eligible for a zero per cent credit conversion factor	Yes