



# Discussion Paper

## **Simplifying the prudential approach to securitisation**

29 April 2014

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## Preamble

This discussion paper outlines the Australian Prudential Regulation Authority's (APRA's) proposed simplification of the prudential framework for the use of securitisation by authorised deposit-taking institutions (ADIs).

APRA invites written submissions on the proposals in this discussion paper. Following consideration of submissions received, APRA expects to release a second consultation package in the first half of 2015 that will include APRA's response to submissions on this discussion paper, a draft prudential standard, prudential practice guide and associated reporting requirements, with a view to implementation in 2016. APRA also intends to release proposed reporting requirements for covered bonds with this second consultation package.

APRA does not intend to finalise any reforms to its prudential framework for securitisation until, at least, the completion of the Financial System Inquiry now underway. APRA will also have regard to proposed revisions to the securitisation framework of the Basel Committee on Banking Supervision, which have been out for consultation since December 2013.

This discussion paper is available on APRA's website at [www.apra.gov.au](http://www.apra.gov.au). Written submissions on the paper should be sent to [APS120review@apra.gov.au](mailto:APS120review@apra.gov.au) by 31 July 2014, and addressed to:

Neil Grummitt  
General Manager, Policy Development  
Policy, Statistics and International Division  
Australian Prudential Regulation Authority  
GPO Box 9836  
SYDNEY NSW 2001

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# Contents

<b>Glossary</b>	<b>6</b>
<b>Executive summary</b>	<b>9</b>
<b>Chapter 1 – Introduction</b>	<b>10</b>
Securitisation and the global financial crisis	11
Basel Committee on Banking Supervision review of securitisation	12
APRA’s review of securitisation	12
<b>Chapter 2 – APRA’s proposed approach to securitisation</b>	<b>14</b>
Key principles	14
Credit risk retention	14
Two credit class structure	15
<b>Chapter 3 – Securitisation for funding purposes</b>	<b>17</b>
Date-based calls	18
Revolving securitisations or master trusts	19
Asset-backed commercial paper and similar programs	20
Funding-only securitisations and ‘all reasonable steps’ for ADI liquidity	21
<b>Chapter 4 – Securitisation for capital relief</b>	<b>22</b>
Related-party investors in the B class	23
Other B class and/or subordinated holdings from any issuer	23
Warehouse arrangements	23
<b>Chapter 5 – Integration with liquidity requirements</b>	<b>25</b>
LCR ADIs	25
MLH ADIs	25
<b>Chapter 6 – Integration with operational risk requirements</b>	<b>26</b>
<b>Chapter 7 – Other securitisation issues</b>	<b>27</b>
Credit derivatives	27
Resecuritisations	27
Basis swaps in securitisation	28
Spread accounts and similar surplus income arrangements	28
Repurchase or replacement of exposures out of the pool	29

Unfunded support	29
Risk-weighting of underlying collateral and trust-back arrangements	30
<b>Chapter 8 – Other issues</b>	<b>31</b>
Self-assessments	31
Prior consultation and APRA approval	31
Consequences of non-compliance	31
Consequential amendments to other prudential standards	32
Artificiality and gaming	32
<b>Chapter 9 – Reporting requirements and transitional arrangements</b>	<b>33</b>
Reporting requirements	33
Transitional arrangements	33
Timeline and proposed release dates	33
<b>Chapter 10 – Request for cost-benefit analysis information</b>	<b>34</b>

## Glossary

Term	Definition
ABCP	Asset-backed commercial paper
ABS	Asset-backed securities
ADI	Authorised deposit-taking institution
Alternative capital treatment	Subject to APRA's prior approval, an originating ADI retaining a subordinated class is able to deduct those holdings from Common Equity Tier 1 Capital. This deduction is capped at the dollar amount of the total capital required, as if the pool of assets were held on-balance sheet. The required deduction is reduced to the extent that the ADI sells down the subordinated class to third-party investors.
APG 120	<i>Prudential Practice Guide APG 120 Securitisation</i>
APRA	Australian Prudential Regulation Authority
APS 001	<i>Prudential Standard APS 001 Definitions</i>
APS 112	<i>Prudential Standard APS 112 Capital Adequacy: Standardised Approach to Credit Risk</i>
APS 113	<i>Prudential Standard APS 113 Capital Adequacy: Internal Ratings-based Approach to Credit Risk</i>
APS 114	<i>Prudential Standard APS 114 Capital Adequacy: Standardised Approach to Operational Risk</i>
APS 115	<i>Prudential Standard APS 115 Capital Adequacy: Advanced Measurement Approaches to Operational Risk</i>
APS 116	<i>Prudential Standard APS 116 Capital Adequacy: Market Risk</i>
APS 120	<i>Prudential Standard APS 120 Securitisation</i>
APS 121	<i>Prudential Standard APS 121 Covered Bonds</i>
APS 210	<i>Prudential Standard APS 210 Liquidity</i>
Banking Act	<i>Banking Act 1959</i>
Basis swap	An interest rate swap aimed at limiting basis risk. A basis swap includes a payment stream on one leg of the swap based on an observable market rate or index, and a payment stream on the other leg based on rates set by a party to the swap.
CDO	Collateralised debt obligation
CLF	Committed Liquidity Facility. This is an alternative treatment for the holding of high-quality liquid assets (HQLA). An ADI is able to establish a secured CLF with the RBA for the purposes of meeting its LCR requirement in Australian dollars.
Common Equity Tier 1 Capital (CET1)	The highest quality component of capital. It is subordinated to all other elements of funding, absorbs losses as and when they occur, has full flexibility of dividend payments and has no maturity date.
Credit enhancement	An arrangement in which an ADI holds a securitisation exposure that is able to absorb losses in the pool and thereby provide credit protection to investors or other parties to the securitisation.

<b>Date-based call</b>	An option that permits the originating ADI to call the exposures in the pool on a predetermined date, before they have been fully repaid.
<b>G20</b>	The Group of Twenty, a forum for international economic cooperation and decision-making.
<b>Implicit support</b>	Support to a securitisation that is in excess of an ADI's explicit contractual obligations.
<b>IOSCO</b>	International Organisation of Securities Commissions
<b>Joint Forum</b>	The Joint Forum was established in 1996 under the aegis of the Basel Committee, IOSCO and the International Association of Insurance Supervisors (IAIS) to deal with issues common to the banking, securities and insurance sectors, including the regulation of financial conglomerates.
<b>LCR requirement</b>	Liquidity Coverage Ratio requirement, to ensure that an ADI has an adequate stock of unencumbered HQLA to meet its liquidity needs for a 30 calendar day liquidity stress scenario.
<b>Managing ADI</b>	An ADI that manages a securitisation. This may include undertaking responsibility for the day-to-day administration of the SPV, allocation of collections, calculation of payments and preparation of investor reports. A managing ADI may also manage swaps, liquidity and other facilities, and events such as issuance, refinancing or calling of securities.
<b>Master trust</b>	Revolving securitisations that allow issuers to periodically sell securities from the same issuing trust, thereby creating multiple series, collateralised by the same pool of receivables and/or mortgages.
<b>MLH</b>	Minimum Liquidity Holdings, a simple liquidity ratio requirement for ADIs that have been exempted from the LCR requirement.
<b>Originating ADI</b>	An ADI that directly or indirectly originates exposures in the pool; is the managing ADI; or provides a facility (other than derivatives) or a credit enhancement to an ABCP securitisation.
<b>Originator</b>	An entity that directly or indirectly originates underlying exposures into the pool.
<b>Pool</b>	The underlying exposure or exposures that are securitised by way of assignment or transfer of rights and obligations to an SPV. The pool may consist of, but need not be limited to, loans, bonds or equities.
<b>RBA</b>	Reserve Bank of Australia
<b>Repo</b>	Repurchase agreement
<b>Resecuritisation</b>	A securitisation exposure in which the risks associated with the underlying pool of exposures are tranching and at least one of the underlying exposures is a securitisation exposure. In addition, an exposure to one or more resecuritisation exposures is a resecuritisation exposure.
<b>RMBS</b>	Residential mortgage-backed securities

<b>Securitisation</b>	A structure where the cash flows from an underlying pool of exposures is used to service at least two tranches or classes of creditors, with each tranche or class reflecting a different degree of credit risk.
<b>Self-securitisation</b>	ADIs undertake self-securitisations, which they retain on their balance sheets and which may be used to obtain liquidity from the RBA in exceptional circumstances.
<b>SPV</b>	Special Purpose Vehicle
<b>Synthetic securitisation</b>	A securitisation whereby only the credit risk, or part of the credit risk, of a pool is transferred to a third party, which need not necessarily be an SPV. The transfer of credit risk can be undertaken through the use of funded (e.g. credit linked notes) or unfunded (e.g. credit default swaps) credit derivatives or guarantees.
<b>Warehouse SPV</b>	An SPV that accumulates exposures until a sufficiently large pool is available for issuance of securities to the market in a securitisation.

## Executive summary

APRA is reviewing its prudential framework for securitisation. APRA's objective is to establish a simplified framework, taking into account the lessons learned from the global financial crisis and global reform initiatives.

One of the main lessons from the crisis was that securitisation had become excessively complex. Globally, securitisation had evolved from its simplest 'originate-to-distribute' form to more complex forms of credit (including synthetic credit or so-called CDOs). This complexity was seen by some as creating more complete and efficient markets. In reality, however, many securitisation structures were less than transparent and masked the relevant risks. The effect was that the risks ultimately 'leaked' back to the issuer, to the potential detriment of its capital adequacy and soundness.

Another main lesson was that, globally, poor incentive arrangements combined with the rapid growth of originate-to-distribute lending put strong pressure on lending standards and practices. This was a key driver of the crisis. Although the quality of securitisations issued by authorised deposit-taking institutions (ADIs) in Australia was generally strong, Australian securitisation markets suffered from the global investor retreat from this financing technique.

Before the crisis, ADIs mainly used securitisation to achieve capital relief, provided that the relevant risks and assets were clearly removed from their balance sheets and off-balance sheet obligations were not created. *Prudential Standard APS 120 Securitisation* (APS 120), which is predicated on securitisation being used for capital relief, sets out the criteria that ADIs must meet to achieve this relief.

As the crisis has receded, some ADIs have placed greater emphasis on securitisation for funding purposes, rather than capital benefits. This has made the current APS 120 less relevant. To provide greater clarity about its requirements, APRA has created an expanded prudential framework for securitisation, supplementing APS 120 with *ad hoc* letters and additional guidance. In practice, this approach has proven unsatisfactory. In response, APRA is proposing to revise its prudential framework for securitisation, taking a more principles-based rather than rules-based approach.

In APRA's view, the prudential framework for securitisation needs, as much as possible, to be clear and simple for stakeholders to understand. APRA's proposed approach includes the following features:

- a set of key principles that apply to securitisation, rather than an expanded set of requirements;
- a simple two credit class structure, which reduces the likelihood of opaque risk transfer and enhances benefits for system stability;
- explicit recognition of funding-only securitisation, with a simple but robust prudential regime that also allows for revolving securitisations or master trusts;
- simpler requirements for capital relief, matching risk to the amount of regulatory capital held;
- better integration of securitisation with the ADI liquidity regime; and
- clarification of the treatment of warehouses and similar structures.

APRA is also proposing a simple 'skin-in-the-game' requirement to mitigate any agency risks inherent in originate-to-distribute lending. This is consistent with the approach being taken by global standard-setters, which emphasises the need for credit risk retention by securitisation issuers.

The securitisation market in Australia has been an important contributor to competition, efficiency and contestability in the ADI industry. Provided securitisations are well-structured, transparent and based on quality assets, these benefits outweigh any additional risks associated with this financing method. In APRA's view, reform of the prudential framework for securitisation will assist in the further recovery of this market.

# Chapter 1 – Introduction

Securitisation is an off-balance sheet financing technique under which an issuer (the originator) bundles together a group of cash-generating assets (the pool) and transfers them to a third party (a Special Purpose Vehicle or SPV). The SPV issues and sells securities (asset-backed securities or ABS) to investors to fund the purchase of these assets. A securitisation typically involves an assignment of the loans (or other assets) from the originator to the SPV.<sup>1</sup> There should be no recourse to the originator of the underlying loans from the holders of the securities issued by the SPV; rather investors in these securities have primary recourse to the cash flows and assets in the SPV. It is this lack of recourse to the originator of the assets that differentiates a securitisation from a covered bond.<sup>2</sup> In Australia, the great majority of securitisation issues have been collateralised by residential mortgages.

Securitisations are usually split into stratified risk positions or ‘classes’ of varying degrees of subordination, with different levels of risk exposure. The senior class or classes have first claim on payments to the SPV. The junior or subordinated class or classes only receive payment once the senior classes are repaid. If there are insufficient funds to make payments on the securities, the junior or subordinated classes absorb losses first. The senior classes are therefore typically lower risk.<sup>3</sup>

Securitisation offers a number of advantages to ADIs. One of the most important is reduced funding costs. Through securitisation, an ADI may borrow at rates determined by the quality of the expected cash flows from the securitised assets, rather than its own credit rating. This enables ADIs with lower ratings or limited access to wholesale funding markets to raise funds at more competitive rates. High ratings for the securities may be achieved through tranching of credit risk and the use of lenders’ mortgage insurance; in Australia’s experience, however, the ratings mostly reflect the relatively sound nature of the residential mortgages that underpin the rating. Securitisation may also lead to better asset and liability management, particularly if a structure provides near or perfect matched funding.

Another advantage is that ADIs may also be able to reduce the amount of regulatory capital APRA requires them to hold against the risks they take by ‘removing’ securitised assets from their balance sheets. APS 120 sets out the criteria that ADIs must meet to achieve capital relief. APS 120 includes general requirements applying to an ADI’s involvement in all types of securitisation activities and the methodology for calculating an ADI’s capital requirement for securitisation exposures.<sup>4</sup> APS 120 requires an ADI to be clearly separate from a securitisation and to clearly disclose the nature and limitation of its involvement in a securitisation to investors. An ADI must also have an appropriate risk management system in place. An ADI must not provide implicit support to a securitisation, that is, support that is in excess of the ADI’s explicit contractual obligations.<sup>5</sup>

1 Occasionally the ‘sale’ to the SPV involves a novation. In Australia, the originator usually gives an equitable mortgage over the assets to the SPV. In legal terms, the SPV holds the assets on trust while the purchasers of the securities become beneficial owners of the assets.

2 In a covered bond, the investor has dual recourse to both the originator and the pool of assets (cover pool) securing the bonds issued. With a covered bond, an ADI does not transfer the risk associated with the assets in the cover pool and continues to hold capital against all of the underlying assets.

3 The junior or subordinated classes of securities in an SPV are often referred to as ‘equity’ because they have a lower priority in the order of repayment. These classes bear the ‘first loss’ in the pool in the same way that the holders of equity in a company are unsecured creditors and bear any losses in the company through any fall in the value of the equity.

4 ADIs must calculate regulatory capital by applying the Standardised Approach to credit risk or the Internal ratings-based Approach to credit risk depending on the approach they take to general credit risk. Foreign ADIs are only required to comply with the provisions in APS 120 relating to disclosure and separation, self-assessment and Board of directors and senior management responsibilities, in relation to their securitisation business in Australia.

5 Refer to paragraph 33 of *Prudential Practice Guide APG 120 Securitisation* (APG 120) for examples of what might constitute implicit support.

## Securitisation and the global financial crisis

### International experience

The origins of the global financial crisis stemmed fundamentally from a failure to properly assess and manage risk. As the Turner Review highlighted, the search for higher returns, largely a result of macroeconomic imbalances, drove the supply of increasingly complex securitisations (including synthetic credit or so-called CDOs) where the risks were not well understood.<sup>6</sup> Although securitisation structures can be simple, in practice they became very complex and opaque. This complexity was alleged to create more complete and efficient markets. In too many cases, however, complexity was used to market unsound products to investors who understood neither the products nor the risks involved. Many of these products also found their way back to bank balance sheets, but in a complicated and less transparent fashion.

Further, poor incentive arrangements combined with the rapid growth of originate-to-distribute lending put strong pressure on lending standards and practice. Agency risk intensified as originators wrote high volumes of poor quality loans that were then securitised in their entirety to raise funds, in many cases in the asset-backed commercial paper (ABCP) markets.<sup>7</sup> The crisis demonstrated that this originate-to-distribute model generated unacceptable prudential risks:

- lack of 'skin-in-the-game' (risk of their own capital) on the part of lenders often led to poor lending quality. Lending without the constraints associated with putting own money at risk too easily led to an unrestrained focus on increasing lending volume at the cost of lending quality;

- the market for new issues of residential mortgage-backed securities (RMBS) can close entirely, regardless of the quality of underlying assets, if investors lose confidence in the lending standards of originators;<sup>8</sup>
- the maturity mismatch involved in using short-term securitisations to fund long-term assets may lead to an almost immediate liquidity crisis when securitisation markets freeze, regardless of an originator's lending standards;
- originators deploying longer-term securitisation structures to fund longer-term assets may not be at immediate risk of illiquidity but may still be unable to raise new funding and maintain lending ability; and
- in many cases, complexity and lack of transparency in securitisation structures create apparently safe investments that are far from safe.

### Australian experience

The quality of ADI residential mortgages backing RMBS issues in Australia was generally strong before and during the crisis. Despite this relatively sound footing, Australian securitisation markets suffered from the global investor retreat from this financing technique when the crisis broke. There were impacts on the profitability of some securitisation structures when credit spreads widened dramatically; some securitisations also suffered from a loss of liquidity.

Securitisation was a comparatively small source of funding for major Australian ADIs prior to the crisis but was an important source of funding for some smaller locally incorporated ADIs. As demand from investors dried up and credit spreads widened, those ADIs that relied on securitisation as a funding tool were forced to either find new funding sources or curtail their lending business. Some ADIs experienced a fall in the value of their investments in offshore securitisation structures. In some cases these investments may have been acquired as apparently low risk products when in fact the risks were considerable.

6 Refer to the 'Turner Review: A regulatory response to the global banking crisis March 2009' at <http://webarchive.nationalarchives.gov.uk/20090321035543/http://www.fsa.gov.uk/pages/Library/Corporate/turner/index.shtml>.

7 Agency risks result from the misalignment of incentives in the securitisation chain. For example, originators may lack motivation to write higher quality loans, since they may no longer have exposure to the loans in the pool.

8 Refer to page 9 of the Joint Forum's 'Report on Special Purposes Entities September 2009' at <http://www.bis.org/publ/joint23.htm>. The process of securitisation meant it was difficult to ascertain the extent of exposure of each institution, and so the market simply took the most conservative stance and contracted lending. This caused the securitisation markets to freeze.

Subsequent public sector intervention helped to underpin demand in the Australian securitisation market. Purchases of RMBS of Australian issuers by the Australian Office of Financial Management (AOFM) supported competition in Australia's residential mortgage markets. This program was designed as a temporary measure to encourage a transition towards a more sustainable securitisation market not reliant on Government financial support.<sup>9</sup> To support liquidity in the market, in 2007 the RBA also broadened the range of eligible collateral under repurchase agreements to include Australian dollar RMBS and ABCP that met strict eligibility criteria.<sup>10</sup>

From a prudential perspective, some ADIs had interpreted the criteria needed to be satisfied to achieve capital relief inappropriately. Faced with an effective shutdown of the market for junior or subordinated classes following the crisis, some ADIs retained these classes in their securitisations and therefore transferred little, if any, of the relevant risks.

Since the crisis began, some ADIs have placed a greater emphasis on securitisation as a source of funding and have been less concerned with securitisation for capital benefits. This has had the effect of making the existing APS 120 less relevant, since it was predicated on securitisation being used primarily for capital relief.

## Basel Committee on Banking Supervision review of securitisation

In December 2013, the Basel Committee on Banking Supervision (Basel Committee) released a second Consultative Document on revisions to the Basel securitisation framework.<sup>11</sup> With a few exceptions, the focus of the Consultative Document is directed at investors in, and facility providers to, securitisations rather than at originators of securitisations. APRA intends to consult on the Basel Committee's proposals when its review is finalised.

## APRA's review of securitisation

Since the crisis began, and in response to various issues raised, APRA has supplemented APS 120 with *ad hoc* letters and additional guidance.<sup>12</sup> In practice, responding to a complicated product with complicated prudential requirements has proven unsatisfactory.

Accordingly, APRA intends to reform APS 120 to provide a simpler approach to securitisation. The proposed approach is more principles-based than rules-based and takes into account the lessons learned from the crisis as well as global reform initiatives.

APRA's objectives are:

- to make it straightforward for ADIs to use securitisation as a funding-only tool;
- to introduce simpler requirements for originating ADIs seeking capital benefits;
- to ensure the new prudential regime incorporates the lessons from the crisis, including those specifically associated with agency risk, complexity and mismatched funding structures;
- to encourage risks to be more appropriately allocated among those with more or less knowledge of the risk, and those with more or less ability to bear any losses;
- to consider systemic risks as well as individual ADI risks; and
- to achieve consistency with Basel Committee requirements, with appropriate adjustments for Australian circumstances.

APRA proposes to define a structure for securitisation that will specifically recognise funding-only securitisations. It will also enable originating ADIs to obtain capital relief, subject to meeting appropriate requirements including the credit risk retention requirements described in Chapter 2.

<sup>9</sup> The AOFM ended the RMBS Investment Program on 10 April 2013.

<sup>10</sup> Refer to <http://www.rba.gov.au/media-releases/2007/mr-07-14.html>.

<sup>11</sup> The Basel Committee's Consultative Document 'Revisions to the securitisation framework - December 2013' is at <http://www.bis.org/press/p131219.htm>.

<sup>12</sup> APS 120 has been varied by a number of letters to industry, which are available at <http://www.apra.gov.au/adi/Publications/Pages/other-information-for-adis.aspx>.

## **Consultation with industry and other interested stakeholders**

APRA invites written submissions on its proposals for a simplified prudential framework for securitisation. APRA encourages all interested stakeholders to use this consultation opportunity to advise of any implementation issues and to submit relevant cost-benefit information.

APRA also welcomes feedback on other options that may address the issues raised, including the likely costs/benefits of each option (see also Chapter 10). For example, APRA seeks feedback on whether industry and other stakeholders see the existing APS 120 as being appropriate and thus not in need of change. Alternatively, stakeholders may consider that APRA's objectives could be met by enhanced guidance rather than new or amended prudential requirements.

## Chapter 2 – APRA’s proposed approach to securitisation

### Key principles

As noted earlier, APRA is proposing to take a more principles-based approach to its prudential requirements for securitisation.

APRA proposes that the following key principles will apply:

- an ADI must deal with the SPV and its investors on an arm’s-length basis and on market terms and conditions;
- an ADI’s involvement in a securitisation must be set out in legal documentation and be limited as to time and amount;
- an ADI must clearly disclose to investors the nature and limitation of its involvement in a securitisation;
- an ADI must not provide, or knowingly create or encourage a perception that it will provide, support to a securitisation in excess of its explicit contractual obligations;
- an ADI may undertake a funding-only or capital relief securitisation;
- credit risks in securitisation must be clearly assigned and properly capitalised;
- the maturity profile of securitisations must appropriately match the maturity profile of the underlying assets or, for short-term assets, match the maturity profile of winding-down or divesting the relevant line of credit; and
- securitisation structures are simple to understand, transparent and low risk.

APRA proposes to revise APS 120 so that it aligns with these key principles and includes appropriate disclosure and separation requirements (similar to those in the existing APS 120). APRA considers that it would be appropriate to extend some existing requirements for capital relief to all securitisations. For example, APRA is proposing that exposures in

the pool continue to be legally isolated from the ADI, that issued securities do not represent obligations of the ADI and that the holders of the securities in the SPV have the right to pledge or exchange them without restriction.

APRA also proposes to continue the existing governance arrangements in APS 120. These include Board and senior management responsibilities, the requirement to perform a self-assessment and arrangements applying to facilities, including derivatives, and services. With a few exceptions, APRA also proposes that the current requirements for acquisition of exposures out of a pool and acquisition of securities by originating ADIs will apply to all securitisations.

### Credit risk retention

Credit risk retention or ‘skin-in-the-game’ is intended to better align the interests of originators and investors and reduce agency risk.

In September 2009, the Group of 20 (G20) Leaders recommended that originators retain a portion of the risk of the underlying assets in order to create a stronger alignment of the interests of originators and investors.<sup>13</sup> Following a request from the G20 and the Financial Stability Board (FSB), the International Organisation of Securities Commissions (IOSCO) published a *Final Report on Global Developments in Securitisation* in November 2012 (the IOSCO report).<sup>14</sup> The IOSCO report did not mandate any particular approach to credit risk retention but recommended that all jurisdictions evaluate and formulate their approach to aligning incentives of originators and investors, including through mandating credit risk retention.

<sup>13</sup> Refer to G20 ‘Leaders’ Statement, *The Pittsburgh Summit*, September 24 – 25 2009’ at: <[https://www.g20.org/official\\_resources/leaders%E2%80%99\\_statement\\_pittsburgh\\_summit](https://www.g20.org/official_resources/leaders%E2%80%99_statement_pittsburgh_summit)>.

<sup>14</sup> The IOSCO report is at <http://www.iosco.org/news/pdf/IOSCONEWS257.pdf>.

Consistent with evolving international practice in this area, APRA proposes that credit risk retention requirements apply only to the originating ADI (the ADI that directly or indirectly originates exposures in the pool). Such requirements will assist in mitigating the agency risks inherent in the originate-to-distribute model and will moderate the potential impact on systemic risk as lenders have a direct economic interest in seeing originated loans repaid. APRA is proposing that originating ADIs be required to retain at least 20 per cent of the junior or subordinated class in each of their securitisation structures. In APRA's view, this percentage should be sufficient to ensure that the incentives of originating ADIs and investors are appropriately aligned. This requirement is discussed further in Chapter 4.

While ADIs maintain a number of linkages to their securitisations, including servicing of the underlying assets and entitlement to surplus income, APRA proposes not to recognise the latter as meeting its proposed credit risk retention requirements. As discussed in Chapter 7, surplus income does not exist at the inception of a securitisation, that is, at the time of transfer of the assets to the SPV. APRA is also proposing not to consider other arrangements, such as a 'representative sample', as meeting credit risk retention. This is because of the added complexities associated with monitoring the randomisation process and any relevant disclosures.<sup>15</sup>

### Multi-seller programmes

APRA notes there are a number of smaller ADIs that use multi-seller programs to issue securitisations. In multi-seller securitisations, there are a number of originators (sellers), directly or indirectly originating exposures into a pool. Imposing a credit risk retention requirement on such programs may expose an ADI to losses attributable to assets originated by other ADIs or other entities.

While it is conceptually possible for each originator into the structure to hold a junior or subordinated class in relation to the assets it originates, industry feedback to APRA indicates that a structure without co-mingled and diversified risk would be materially less attractive to investors.

APRA invites feedback from industry on how a credit risk retention requirement for multi-seller programs could be structured that is consistent with APRA's objectives and addresses the problem of shared risk among originators.

### Two credit class structure

APRA proposes, for prudential purposes, that a securitisation consist of two credit classes:

- the 'A' class, the senior portion of the structure; and
- the 'B' class, the junior or subordinated (or equity) portion of the structure.

In APRA's view, risk may be transferred in a more certain manner from ADIs to investors in a structure with only two credit classes. This is because the risk profile of a mezzanine class may unduly complicate a structure, and may lead to opaque risk transfer without any offsetting systemic benefits.

At the same time, APRA is proposing that any given securitisation structure may possess multiple tranches within the A class, provided they rank *pari passu* for credit purposes. This means, for example, that a structure could contain several fixed tranches with differing maturities, plus a pass-through tranche. Tranches with shorter maturities could rank before tranches with longer maturities for the purposes of repayment.

<sup>15</sup> A representative sample is a method of credit risk retention whereby an originator retains a randomly selected representative sample of assets, equal to the unpaid principal balance of all pool assets initially identified for securitising that is equivalent in all material respects to the securitised assets.

APRA proposes to remove the current 20 per cent securities holding limit.<sup>16</sup> This means that an ADI could trade in its own A class securities provided this is incidental to its normal activities in financial markets, e.g. market-making. However, APRA proposes to place restrictions on an originating ADI if trading does not occur in the normal course of business or if the activity may provide implicit support to a securitisation.

APRA proposes that an ADI may trade in another issuer's A class securities without restriction. Risk-weightings for such holdings would use either the existing capital requirements under APS 120 or, for those instruments held in the trading book, the requirements of *Prudential Standard APS 116 Capital Adequacy: Market Risk* (APS 116).<sup>17</sup>

Under its proposals, APRA anticipates that substantially all the credit risk will be concentrated in the B class. As discussed later in this paper, APRA is proposing to provide for multiple sub-classes within the B class, for ADIs seeking capital relief for the relevant securitisation. Whilst securitisation may be viewed for prudential purposes as a two-credit class structure, in commercial terms, an ADI could structure as many mezzanine and junior or subordinated classes as it sees appropriate.

16 Under the existing APS 120 (paragraph 8(c) of Attachment F), an originating ADI must ensure, on an on-going basis, that the volume of securities (held in both the trading and banking book) is not disproportionate to the amount of securities outstanding issued by the SPV (i.e. the volume must be less than 20 per cent of the value of securities outstanding).

17 For capital adequacy purposes securitisation exposures held in an ADI's trading book are subject to the requirements of *Prudential Standard APS 116 Capital Adequacy: Market Risk* (APS 116), except that exposures required to be deducted or risk weighted at 1250 per cent if they were held in the banking book must be subject to the same capital requirements in the trading book.

## Chapter 3 – Securitisation for funding purposes

Some ADIs use securitisation to source long-term funding, typically concentrated on AAA rated issues of RMBS. Since the dislocations to global funding markets in the crisis, many ADIs have sought to further diversify their sources of funding. A number of ADIs issued covered bonds following amendments to the Banking Act that allowed such issues.<sup>18</sup> Although covered bonds are an attractive source of funding for larger ADIs, they are less accessible for smaller ADIs, which are often unrated and which do not have the volume of assets required to issue covered bonds. Funding-only securitisation provides ADIs with another tool to diversify their funding.

In line with Basel Committee requirements, the current APS 120 focuses on capital relief. The standard includes conditions for achieving significant credit risk transfer to third parties, including a prohibition on originating ADIs retaining holdings in assets from pools or securities issued by securitisation structures in excess of certain thresholds. Before the crisis it was possible to meet these conditions, with a ready pool of investors providing liquidity in all classes of a securitisation, allowing ADIs to fund their mortgage portfolios at low cost. Subsequently, a number of ADIs were unable to sell the junior or subordinated classes at economic prices. As an interim measure, APRA agreed to allow a form of funding-only securitisation and apply what it termed an alternative capital treatment.<sup>19</sup>

APRA is proposing that the revised APS 120 explicitly recognise funding-only securitisations. Any funding-only securitisation structure would have only one B class (with no sub-classes of subordinated securities). It is intended that, in a funding-only securitisation, the originating ADI will hold the entirety of the B class.

The revised APS 120 will also explicitly cater for self-securitisations as funding-only securitisations. In a self-securitisation, the ADI holds all of the securities issued by the SPV until needed to obtain liquidity from the RBA.<sup>20</sup> APRA proposes that self-securitisations must be structured in the same way as funding-only securitisations so as to facilitate a seamless transition, ultimately, to a structure where there is an external beneficial interest.

Originating ADIs will need to designate each securitisation as funding-only or for capital relief at the inception of the transaction.

There is no capital relief available in a funding-only securitisation structure because the originating ADI retains substantially all the credit risk. APRA proposes that the capital requirements for the underlying assets will flow from the relevant treatment under either the Standardised approaches to credit risk set out in *Prudential Standard APS 112 Capital Adequacy: Standardised Approach to Credit Risk* (APS 112) or the Internal Ratings-based (IRB) approaches set out in *Prudential Standard APS 113 Capital Adequacy: Internal Ratings-based Approach to Credit Risk* (APS 113).

The alternative capital treatment would cease from the effective date of the revised standard, subject to appropriate transitional arrangements for existing structures.<sup>21</sup>

<sup>18</sup> The *Banking Amendment (Covered Bonds) Act 2011* (Covered Bonds Act) amended the *Banking Act 1959* (Banking Act) to allow ADIs to issue covered bonds.

<sup>19</sup> After securitisation markets struck difficulties in 2007/08, a number of ADIs originated securitisations under which the senior classes were placed with third-party investors but the originating ADI retained all, or nearly all, of the securitisation's most junior or subordinated class. Some ADI issuers retained the assets and capital requirements on their balance sheets on the basis that the structure failed to meet the requirement for significant credit risk transfer in APS 120; others did not. APRA always intended the alternate capital treatment to be an interim measure pending this review. Paragraph 8 of APS 120 effective 1 January 2012 was replaced by the existing APS 120 effective 1 January 2013. This paragraph set out the process whereby ADIs could, in exceptional circumstances, approach APRA to seek approval of structures where significant credit risk transfer was not achieved, e.g. where the originating ADI retained the junior or subordinated class in the structure.

<sup>20</sup> ADIs undertake self-securitisations, which they retain on their balance sheets and which may be used to obtain liquidity from the RBA in exceptional circumstances.

<sup>21</sup> Refer to Letter to industry dated 18 November 2011 'Securitisation – Pre-approval of securitisations' at <http://www.apra.gov.au/adi/Publications/Pages/other-information-for-adis.aspx>.

## Date-based calls

Under a date-based call, an originating ADI has an option, but not an obligation, to repurchase exposures from an SPV on a specified date, which is determined at the beginning of the securitisation.

The existing APS 120 restricts an originating ADI's ability to enter into such calls to a clean-up call where the principal outstanding has amortised to 90 per cent or more of the value of the pool. This is because at that point there is only a small amount in the pool, which may be uneconomic to service.<sup>22</sup> The objective of limiting calls to the 10 per cent clean-up is to ensure calls are not used to provide credit enhancement to investors. APRA's intention is that an originating ADI should not make use of clean-up calls if this would increase the ADI's exposure to losses or deterioration in the credit quality of the underlying exposures.

Industry participants have submitted that originating ADIs should have an express ability to make date-based calls. The main benefit cited is that date-based calls reduce extension risk, the risk that securities are repaid at a date later than expected by investors because borrowers have been slower to repay their loans than anticipated at the securitisation's inception. If a security is repaid over a longer period than expected, it is possible that the investor's return would not provide an attractive yield when compared to a relevant benchmark. Date-based calls are said to create a number of flow-on benefits, including:

- increased investor participation in the Australian RMBS market with the ability to set an implied maturity on an issue and therefore meet institutional investor demand;
- improved pricing because of a reduction in uncertainty around maturity;
- improved secondary market functionality; and
- improved pricing of cross-currency swaps for RMBS structures issued in foreign currencies.

<sup>22</sup> Once the pool has amortised to 90 per cent or more of the value of the pool, it is usual for the margin on any outstanding securities to increase. This also creates an incentive for the ADI to refinance junior or subordinated classes through other means.

The contrary view is that date-based calls outside the 10 per cent clean-up shift the timing risks on winding down the pool from the investor to the originator. Date-based calls outside the 10 per cent clean-up facilitate an early exit for investors, protecting them from absorbing credit losses had they otherwise remained in the securitisation.

APRA proposes to amend APS 120 to allow originators to set a call date for funding-only securitisations, but only on the following basis:

- an originating ADI must have full discretion to exercise the date-based call;
- the date-based call is set at inception of a securitisation at a date no earlier than the projected 10 per cent clean-up point;
- the date-based call must not serve as a credit enhancement. There must be no recourse to the originating ADI. Investors bear the full amount of all credit risk that exceeds the risk retained by the originating ADI (e.g. through any holding of the junior or subordinated class in the structure) at the exercise of the call;
- where a funding-only securitisation incorporates a date-based call, an originating ADI cannot convert a funding-only securitisation into a capital relief securitisation. The originating ADI will need to clearly distinguish the type of securitisation from the outset of the transaction; and
- for liquidity purposes, the date-based call must be modelled at the earliest date that the originating ADI is able to exercise its option to make the call.

APRA does not propose to allow date-based calls in capital relief securitisations. APRA notes that the Basel Committee also does not allow for date-based calls in such securitisations.<sup>23 24</sup>

<sup>23</sup> Refer to paragraphs 557-559 of 'Basel II: International Convergence of Capital Measurement and Capital Standards: A Revised Framework - Comprehensive Version - 2006' at <http://www.bis.org/publ/bcbs128.htm>.

<sup>24</sup> The existing APS 120 requires a securitisation SPV to be financially and operationally independent of the originating ADI. This reflects the philosophy underpinning the existing APS 120 that a securitisation involves a 'clean sale' and is more than a funding mechanism. The existing APS 120 envisages a securitisation as an arrangement where the pool of exposures is sold to an SPV, with the intention that the underlying exposures will not return to the originating ADI except in very limited circumstances. Date-based calls are inconsistent with the fundamental principle of clean sale; when an originating ADI is compelled to make a call for economic reasons, a securitisation is indistinguishable from an on-balance sheet secured funding arrangement.

## Revolving securitisations or master trusts

Revolving securitisations or master trusts allow issuers to periodically sell securities from the same issuing trust, thereby creating multiple series collateralised by the same pool of receivables and/or mortgages. The exposures in the pool change over time, in that new assets are added as existing assets are paid down. This is known as the 'revolving phase'. Once the revolving phase ends a master trust moves into the amortisation phase.

In the case of master trusts, the securitisation vehicle will usually hold more assets than are needed to back the securities sold to third-party investors.<sup>25</sup> If these excess assets, usually called the 'seller share', are subordinated to third-party investors, then the master trust essentially operates like a covered bond.

The ability to make bullet repayments is argued to be one of the key benefits of master trusts. Investors are said to favour bullet repayments because they reduce extension risk. One of the key issues is how to fund these bullets. There are two types of bullet repayments: 'soft bullets' and 'hard bullets'.<sup>26</sup>

It is possible to generate the cash flows required to repay a soft bullet independently of any facility provided by the manager of the master trust or the originating ADI, if the seller share is sufficiently large to generate adequate cash flows within the structure, or if a third party provides a liquidity facility. This need not imply that risk returns to the originating ADI. Alternatively, the originating ADI can facilitate the repayment by a date-based call and/or liquidity facility.

Allowing an originating ADI to fund a date-based call, other than at the projected 10 per cent clean-up point, and/or provide a liquidity facility to fund a bullet potentially provides a mechanism to transfer losses to the originating ADI that otherwise would be borne by investors if the portfolio ran to maturity. This may provide investors with an extra line of support from the seller, i.e. access to the assets in the pool and support from the originating ADI, because the call option facilitates repayment of their investment. These characteristics are also similar to those of covered bonds. Master trusts are generally designed to be called on the maturity date of a bullet and are priced on the expectation that the originating ADI will, almost always, exercise the option to make the call. From the investors' perspective, this creates an expectation that they will be paid out by the originating ADI or have recourse to the assets in the pool.

Master trusts also generally include asset triggers, designed to accelerate the unwinding of the securitisation by amortising the investors' interest prior to the originally anticipated amortisation date.<sup>27</sup> This potential to reduce investors' exposure early may shift losses to the ADI that would have fallen to investors had the revolving phase continued to the date originally scheduled for entering the amortisation phase. For this reason, investors do not share in the same losses as they would in a static pool, or in a revolving pool that continued to the originally scheduled amortisation date. Similarly, non-asset triggers that also bring forward amortisation of the investors' interest may be designed to enhance the creditworthiness of the senior classes.

25 In a master trust structure, the revolving pool of mortgages and/or receivables collateralises two beneficiaries - the 'seller share', retained by the originating ADI and the investors' or 'funding share', which is equivalent to all securities outstanding. The seller share is equivalent in size to the total asset pool less the funding share and is designed to absorb fluctuations in the monthly outstanding loan balances.

26 'Soft bullets' involve an option but not an obligation on the part of the issuer to repay a given debt tranche or class on a given date. 'Hard bullets' involve a contractual obligation to repay an amount on a given date, in the same way that bonds and term deposits involve a contractual obligation on the part of an ADI to make a payment on a given date.

27 'Asset triggers' usually relate to the credit quality of the assets in the pool. 'Non-asset triggers' relate to such events as the insolvency of the originating ADI (seller) or a breach of the contractually specified minimum size of the seller share.

The Basel Committee has commented that it considers that securitisations with early amortisation provisions typically result in very limited, if any, transfer of risk to investors.<sup>28</sup> This is because early amortisation provisions are generally designed to subordinate the originator's interest. The Basel Committee proposes that all securitised assets in these structures be assessed as if they were on-balance sheet for regulatory capital purposes. APRA considers this an appropriate approach.

Accordingly, APRA proposes to accommodate master trusts within its revised framework as funding-only securitisations only.

Under this proposal, the seller share would not attract an additional capital charge or deduction from Common Equity Tier 1 Capital (CET1) provided it is not structurally subordinated in any way to the most senior class in the structure. This means that the seller share and the most senior class would amortise at the same rate so both shares would reach zero at the same time. APRA does not propose to allow early amortisation triggers, whether associated with asset or non-asset triggers, as such triggers may also create a surrogate covered bond.

## Asset-backed commercial paper and similar programs

The crisis demonstrated that potential credit support on the part of the originator is generally more likely with programs such as asset-backed commercial paper (ABCP) securitisations. ABCP securitisations are usually managed by ADIs and are used to fund an ADI's own assets and/or those of other originators. An ADI generally provides a liquidity facility and a system-wide credit enhancement to the structure. These programs can be either single or multi-seller structures.

ABCP securitisations borrow at short maturities (where rates are generally lower) and invest in longer-dated, higher-yielding assets. If it is not possible to refinance the commercial paper, and if assets are not paying down sufficiently quickly, the liquidity facility is drawn, often at considerable expense, to repay the outstanding commercial paper. The crisis demonstrated that the liquidity facility is, almost always, fully drawn when commercial paper cannot be rolled forward.

Experience has shown that at a systemic level, ABCP securitisation tends to flourish when credit markets are strong to overheating, then dries up more or less completely when credit markets tighten. This is highly pro-cyclical, and not consistent with prudent lending arrangements that continue to support borrowers during adverse external circumstances.

APRA's revised prudential framework proposes to allow for short-term funding using ABCP or similar instruments only as funding-only securitisations. APRA proposes to require that these programs have sound funding arrangements in place to cater for a (hypothetical) two-year closure of securitisation markets. In this context, 'sound funding arrangements' mean that the originating ADI can demonstrate its ability to run down the underlying assets faster than outstanding liabilities, without replacing the assets. Alternatively, there must be committed lines of credit or similar support from a third party to cover a hiatus in the securitisation market of up to two years.

APRA proposes that any core lines of business funded through short-term securitisation programs cannot as a practical matter be run down and not replaced, even if the contractual maturity of assets in this program on any given day is short-term. APRA does not consider that an originating ADI could realistically, for example, close its small and medium enterprise (SME) lending or credit card businesses as part of a short-term response to a liquidity shock.

<sup>28</sup> Refer to page 17 of the Basel Committee's Consultative Document 'Revisions to the securitisation framework - December 2013' at <http://www.bis.org/press/p131219.htm>.

## Funding-only securitisations and 'all reasonable steps' for ADI liquidity

APRA recently released its final position on implementation of the main elements of the Basel III liquidity reforms for ADIs in Australia.<sup>29</sup> Under the liquidity reforms, many larger ADIs will receive access to a secured committed liquidity facility (CLF) from the RBA in partial support of their liquidity coverage ratio (LCR) requirement. Access to the CLF is predicated upon ADIs taking 'all reasonable steps' to meet their liquidity requirements from their own balance sheet management before relying upon the CLF.

APRA's proposed reforms to the funding-only securitisation regime, particularly the removal of the 20 per cent securities holding limit, will allow larger ADIs to increase their term wholesale funding via securitisation, in the same way that in recent years they have increased their term wholesale funding through covered bonds. Accordingly, APRA considers that the use of funding-only securitisation will provide an opportunity for ADIs to replace short-term debt in the 'all reasonable steps' context. APRA will discuss with relevant ADIs the degree to which increased term securitisation liabilities will replace shorter-term, unsecured wholesale liabilities.

Further details regarding the integration of the securitisation framework with liquidity requirements are discussed in Chapter 5.

<sup>29</sup> Refer to [http://www.apra.gov.au/MediaReleases/Pages/13\\_39.aspx](http://www.apra.gov.au/MediaReleases/Pages/13_39.aspx)

## Chapter 4 – Securitisation for capital relief

APRA proposes to continue to allow originating ADIs to achieve capital relief using securitisation, taking the principles outlined in Chapter 2 as the starting point.

In reviewing its prudential approach to securitisation for capital relief purposes, APRA is considering one of two approaches.

### (a) Significant credit risk transfer

One option is to maintain the current approach under APS 120, based on the Basel Committee's securitisation framework, that significant credit risk must be transferred in order to recognise any benefits from a securitisation for the originating ADI. Under this approach, an originating ADI may exclude the underlying assets from its calculation of credit risk-weighted assets if significant credit risk is transferred to third parties. This approach requires an originating ADI to use its judgement as to whether it believes the principle of significant credit risk transfer has been met. For example, an originating ADI would need to consider the proportion and the risk position of any securities it holds from the securitisation as part of its self-assessment.

### (b) Pro rata approach

The alternative is a *pro rata* approach, which provides for a reduction in capital requirements to the extent that an originating ADI can sell the B class securities to third parties. To calculate the credit risk capital requirements under a *pro rata* approach, either APS 112 or APS 113 will apply, where appropriate.

As an example, if an originating ADI sells down the B class securities to the proposed minimum 'skin-in-the-game' requirement of 20 per cent, it would achieve an 80 per cent reduction in credit risk-weighted assets under a *pro rata* approach. This approach creates a simple method for originating ADIs to achieve a reduction in capital requirements as appropriate.

Whichever approach is adopted by APRA, there will be a minimum credit risk retention requirement of 20 per cent of the B class. In addition, an originating ADI will be required to hold capital, calculated in accordance with APS 120, for any other exposures it may have to the SPV, e.g. liquidity, underwriting or funding facilities, derivative transactions or holdings of its own A class. Such exposures would be subject to a maximum capital charge.<sup>30</sup>

APRA does not propose to allow an originating ADI to repurchase any part of its own B class securities once sold.

APRA invites submissions from ADIs on the merits of both approaches, including the extent to which each approach matches risk to the amount of regulatory capital held.

### Multiple sub-classes of the B class

Limiting securitisations to two classes would prevent ADIs from creating so-called mezzanine classes. As an alternative to a single B class, some ADIs may wish to create structures that provide for multiple sub-classes of subordinated securities to satisfy investor appetite.

APRA proposes to allow ADIs to issue multiple sub-classes of subordinated securities, but with the originating ADI holding at least 20 per cent of each sub-class.

Under a *pro rata* approach, the originating ADI would only gain capital relief against the largest proportional holding in the sub-classes of subordinated securities. For example, experience suggests that an A class is likely to have a AAA rating and there could be three sub-classes of subordinated securities, B1, B2 and B3, which by definition need not be *pari passu* for credit purposes. If the ADI retains 20 per cent of B1, 50 per cent of B2 and 70 per cent of B3, the ADI would be eligible for a 30 per cent reduction in capital requirements associated with the underlying assets, that is, 100 per cent minus 70 per cent.

<sup>30</sup> The capital charge for the securitisation will be no more than the capital charge associated with the direct holding of the underlying assets of the pool. Where an ADI provides several types of facilities, and the drawdown on one facility precludes (in part) a drawdown on another facility, it may, to the extent these positions overlap, include only that exposure, or portion of exposure, that produces the higher amount of regulatory capital.

This means that capital relief securitisations may feature either a single B class, with a proportion of the B class held by the originating ADI, or, alternatively, multiple sub-classes of the B class, with a proportion of each sub-class held by the originating ADI. In commercial terms, the latter option would enable an ADI to structure as many mezzanine and junior or subordinated classes as appropriate.

APRA invites submissions from both originating ADIs and potential B class investors on the types of structures that would appropriately capture the proposed credit risk retention requirements, the likely pricing for the B class securities, and the potential appetite of investors for such securities. In inviting such submissions, APRA notes that it would have little appetite for arrangements that are more complex than those outlined above.

### **Related-party investors in the B class**

APRA proposes that an originating ADI may sell the B class to a related party regulated by APRA, such as an insurance company or superannuation fund acting on behalf of beneficiaries/members, if this activity occurs in the normal course of business and is in accordance with the related party's investment mandates and/or strategies. The related party would need to be able to demonstrate that these investments are consistent with its risk appetite and are within its policies on the types and limits for these types of assets. The most appropriate way to demonstrate this is through the originating ADI placing the B class to a range of independent investors, as well as to related-party investors.

Where an originating ADI sells the B class to a member of a group to which it belongs, and the member of the group, in purchasing the B class, does not act on behalf of beneficiaries/members, the sale of the B class will not be recognised. This is because risk has not been transferred outside of the group.

### **Other B class and/or subordinated holdings from any issuer**

When an ADI takes on credit exposures originated by other ADIs, contagion risk in the financial system increases. Further, any arrangement in which an ADI invests in subordinated classes of securitisations issued by non-ADIs is unlikely to reduce, and may increase, systemic risk.

For that reason, APRA is proposing that any ADI investing in another ADI's B class securities, whether held in the trading or banking book, will need to deduct such investments from CET1. Similarly, any ADI investing in anything other than the senior classes of any securitisation issued by any type of issuer will attract a CET1 deduction.

### **Warehouse arrangements**

Warehouse arrangements allow ADIs to aggregate residential mortgages until they are ready to issue into the market in a securitisation. Warehouses can promote more efficient access to markets for the issuance of term securitisations and can therefore lead to greater diversity of funding at a lower cost.

Traditional securitisation involves both the provision of long-term funds to a lender broadly matching the underlying assets and, where appropriate, capital relief. In contrast, warehouse arrangements are meant to be temporary arrangements and the over-riding premise that the term of funding matches the term of the underlying assets is not met with a warehouse structure.

Although the contractual life of a warehouse SPV is shorter than a term securitisation, its actual duration may be less certain. A number of small ADIs accumulate residential mortgage assets into warehouses and may have no control over when a term securitisation is possible in the market. As a result, warehouse funding providers are exposed to the risks of the warehouse arrangement, i.e. the rollover/refinance risk should a term issue not occur prior to the notional expiry of the warehouse. As the crisis illustrated, some warehouse funding providers overlooked this rollover/refinance risk, particularly those that had made a business decision to withdraw from the warehouse funding market.

In addition, once an originating ADI claims capital relief for assets sold into warehouses, it should effectively be in the same position as if it had sold those assets to maturity; it should not be able to repurchase the assets and/or provide additional credit enhancements. Alternatively, an originating ADI may find it more efficient to build-up and hold the assets on its own balance sheet until the issue of securities in a term securitisation is imminent.

Under the current APS 120, APRA grants a concessional treatment for warehouse providers in allowing them to risk-weight the exposure to the warehouse under APRA's securitisation framework, even though the securitisation has not been placed in the market. This results in lower capital being held in the banking system against the credit risk on residential mortgages. APRA has been willing to grant this concession on the basis that warehouse arrangements are temporary. In recent years, however, some warehouses have proven to be ongoing, leading to more sustained capital leakage because the assets have not been funded through a true third-party securitisation. Although a warehouse has benefits as an aggregation model, APRA has concerns with its use as anything other than a temporary arrangement. Accordingly, APRA is proposing to limit the concessional capital treatment to warehouse arrangements up to one year.

APRA currently extends a further concession to ADIs to treat warehouse SPVs as securitisations even if they do not have at least two different tranches or classes of creditors. However, APRA understands that the predominant form of warehouse SPVs currently in place involves at least two tranches or classes of creditors. Moreover, in APRA's view, proposed credit risk retention requirements effectively render the existing concession obsolete. APRA therefore proposes to remove this concession, which will also align more closely with the Basel Committee's securitisation framework.

APRA proposes to accommodate warehouse arrangements in the revised APS 120 on the following basis:

- a warehouse SPV is a securitisation if it has at least two tranches or classes of creditors;
- on establishment of a warehouse, an originating ADI may treat the warehouse as either funding-only or for capital relief, subject to credit risk retention requirements, and the warehouse funder may treat the funding as a securitisation exposure under APS 120;
- if residential mortgages remain in a warehouse after a period of one year, i.e. the assets have not been transferred to a term securitisation, the ADI providing the warehouse funding will incur a capital charge as if the assets were on its balance sheet, under APS 112 or APS 113 as appropriate. This applies to the warehouse funder regardless of whether the originator is an ADI or other entity, as the warehouse funder holds the rollover/ refinance risk; and
- warehouse SPVs are temporary arrangements and APRA would not normally envisage a role for clean-up calls in warehouse structures.

## Chapter 5 – Integration with liquidity requirements

Recent crisis experience has demonstrated that reliance on securitisation to fund long-term assets in short-term markets is inherently unsound. Therefore, APRA would expect that the originating ADI matches the expected underlying asset tenor with appropriate liability tenors. ‘Appropriate’ in this context does not necessarily imply ‘fully matched’ but means that term assets are funded by suitably termed liabilities.

As noted above, APRA recently released its final position on implementation of the main elements of the Basel III liquidity reforms for ADIs in Australia. *Prudential Standard APS 210 Liquidity* (APS 210) came into force on 1 January 2014. The appropriate liquidity treatment for securitisations is considered in the context of the liquidity metric under which each originating ADI is supervised, i.e. whether an ADI is classified as a Liquidity Coverage Ratio (LCR) ADI or an ADI subject to the Minimum Liquidity Holdings (MLH) regime.

### LCR ADIs

For LCR ADIs, APRA proposes that the originating ADI treat the SPV on-balance sheet when calculating the LCR under APS 210.

Where securitisations include call options allowing the originating ADI to repurchase the securitised assets, there can be significant market pressure on that ADI to repurchase those assets on the call date. For liquidity purposes, any call option associated with a securitisation structure must be modelled at the first date the originating ADI is able to exercise its option to make the call.

### MLH ADIs

For originating ADIs on the MLH regime, APRA proposes that the underlying liabilities of the SPV be excluded from the calculation of the liabilities base in the MLH ratio under certain circumstances.

APRA’s proposed liquidity treatment for originating ADIs using the MLH regime is as follows:

- term securitisations – in term securitisations the assets and liabilities of the SPV are approximately maturity matched; as a result, the liabilities of

term securitisations may be excluded from the calculation of liabilities in the MLH ratio.

- ABCP securitisations – in these structures short-term securities are issued against both short-term and long-term assets. Liquidity facilities typically provided by a third party ADI may also be put in place over the securitisation, to cover the liquidity risk associated with the mismatch of tenors. However, these facilities do not in themselves achieve full liquidity risk transfer as the funding term is not matched to the life of the assets. Therefore, originating ADIs will be required to include the liabilities of the SPV in the calculation of the MLH ratio.
- warehouse SPVs – in these structures a third party ADI generally provides the warehouse funding in the warehouse’s initial phase. At the end of this initial phase, if securities are not issued to the market in a term securitisation, the warehouse funding is generally rolled forward. Under these arrangements, there is no contractual requirement on the originating ADI to repurchase the assets. Hence, the originating ADI will not be required to include the liabilities of the SPV in the calculation of the MLH ratio.
- self-securitisations – in these structures an originating ADI has not sourced third-party funding for the SPV. The assets of self-securitised structures are on-balance sheet, and hence the calculation of the MLH ratio will include on-balance sheet liabilities that are funding those assets.

MLH ADIs are currently able to exclude clean-up calls from their liabilities for the purposes of the calculation of the MLH ratio. It is APRA’s expectation that MLH ADIs will address the liquidity risk associated with clean-up calls through their liquidity policies. In addition, MLH ADIs will need to model clean-up calls in the ‘going concern’ scenario that APRA requires all ADIs to complete from 1 January 2014.<sup>31</sup>

<sup>31</sup> The ‘going concern’ scenario requires an ADI to model the expected behaviour of cashflows in the ordinary course of business for a future period of at least 15 months, as described in Attachment B of APS 210.

## Chapter 6 – Integration with operational risk requirements

As noted in Chapter 9, APRA proposes that an originating ADI report the SPV on-balance sheet for prudential reporting.

Where the SPV is currently reported as off-balance sheet for prudential reporting, this proposal may have the effect of increasing the level of operational risk regulatory capital calculated in accordance with *APS 114 Capital Adequacy: Standardised Approach to Operational Risk* (APS 114) or *APS 115 Capital Adequacy: Advanced Measurement Approaches to Operational Risk* (APS 115).

APRA's view is that such an increase may be appropriate as the operational risks associated with originating, managing or providing services to a securitisation are similar whether or not the SPV is consolidated for accounting purposes. In addition, the different forms of securitisation recognised under APRA's proposed simplified framework, which include funding-only and self-securitisations, may have differing accounting consolidation outcomes and APRA's view is that a consistent approach to the calculation of operational risk regulatory capital is appropriate.

APRA does not expect that the impact of this proposal on the operational risk capital charge will be material. However, APRA may consider phasing-in the impact on a case-by-case basis, if the proposal proves to be material in particular cases. ADIs impacted in that way are encouraged to detail the type of transitional arrangements they may need in their submissions on this discussion paper.

## Chapter 7 – Other securitisation issues

### Credit derivatives

Under the current APS 120, an ADI may obtain capital relief by acquiring a guarantee or credit derivative on a securitisation exposure. The resultant risk-weighting becomes the lower of the risk-weight applicable on the exposure, or the credit derivative provider.

Under APRA's proposed framework, the B class securities will embody substantially all of the credit risk associated with the securitised assets. Although credit derivatives can play a legitimate role in securitisation structures, APRA considers that it is appropriate that capital relief is only extended where there is no scenario in which an ADI might incur a loss on exposures without the B class first being sold to third parties, subject to the proposed credit risk retention requirements.

APRA proposes that only physical sales of the B class securities will attract capital relief. Therefore, in the case of the B class, the originating ADI will not be able to claim capital relief from the use of credit risk mitigation techniques. This is to ensure that originating ADIs obtain capital relief only if the B class is sold to third parties. ADIs investing in anything other than the senior classes of any other securitisations issued by any type of issuer will not be able to use credit risk mitigation to remove the requirement to deduct the exposure from CET1.

Synthetic securitisations involve at least two different stratified risk positions that reflect different degrees of credit risk, where the credit risk of an underlying pool of exposures is hedged, in whole or in part, through the use of credit derivatives or guarantees. One of the lessons from the crisis is that synthetic securitisations can be highly volatile instruments of speculative value only, often dependent on less-than-robust statistical models and often unconnected to any physical lending activities.

APRA proposes that an ADI may continue to apply credit risk mitigation techniques to exposures other than the B class and obtain a reduction in capital requirements, provided the techniques do not amount to synthetic securitisations. An ADI may not claim capital relief from synthetic securitisations. Synthetic securitisations are uncommon in Australia and, in

APRA's view, have limited use from a system stability perspective as they are not undertaken for the purpose of funding.

### Resecuritisations

In a resecuritisation, the underlying assets are themselves liabilities of SPVs, usually the junior or subordinated classes of primary securitisations. Resecuritisations include CDOs. Resecuritisations proved highly problematic during the crisis, not only because of the underlying credit quality of the pools but also because of the added complexity, lack of transparency and increasing leverage associated with the structures. Globally, resecuritisations were the source of significant losses during the crisis and were more highly correlated with risk than traditional securitisations.

In APRA's view, the great majority of the competition and efficiency benefits associated with securitisation can be achieved in simple structures, and a disproportionate share of risks seems to be associated with complex structures. Accordingly, APRA proposes that resecuritisation exposures, including senior classes, be treated as equivalent to B class investments and deducted from CET1.

An ADI will continue to be expected to treat, as resecuritisations, claims on a pool that is permitted to invest excess cash in authorised investments that can include a securitisation exposure.<sup>32</sup> In considering whether a conduit structure, typically an ABCP securitisation, is a resecuritisation, APRA will continue to expect ADIs to consider the economic effect of the whole structure, rather than the status of each SPV in the structure on a stand-alone basis.<sup>33</sup> If the economic effect of the whole structure is a securitisation, each SPV in the structure is deemed to be a securitisation. On this basis, claims on most conduits will be considered resecuritisation exposures. As each SPV is deemed a securitisation, a claim on any one SPV that holds securities issued by another SPV would be a resecuritisation exposure.

<sup>32</sup> See *Prudential Practice Guide APG 120 Securitisation*, paragraph 60. Note that where an ADI can establish that, despite the terms of the mandate, a scheme in place prior to December 2009 does not currently invest in such securities and will not do so in future, it may regard the claims as securitisation exposures.

<sup>33</sup> Conduit structures usually hold a much broader range of assets (e.g. individual loans and ABS) than individual trusts and fund themselves by issuing ABCP.

## Basis swaps in securitisation

In a securitisation, the basis on which underlying assets are priced generally differs from the basis on which payments are made to investors. Loans may be at fixed or variable rates, priced as a function of the ADI's cost of funds.<sup>34</sup> However, the securities issued to investors are based on a reference rate, e.g. the Bank Bill Swap Rate plus an agreed margin. Basis swaps provide a mechanism to transform the nature of the cash flows from the underlying assets to meet the needs of investors in a securitisation.

There is no standard pricing benchmark or transparent market for these swaps. The current APS 120 accommodates basis swaps provided the swap has sufficient margin so that the originating ADI is not expected to be a net payer over the life of the securitisation.

As the costs of securitisation increased dramatically during the crisis, a number of ADIs became net payers under basis swaps. In some cases, threshold rate mechanisms were not enforced and sufficient income was credited to total investor revenues to allow payments to investors to continue.<sup>35</sup> Whilst APRA acknowledges the significant market movements that generated these circumstances, from a prudential perspective the ADI could be considered to be supporting the cash flows of the SPV through the provision of the swap.

APRA proposes to continue the current treatment and allow ADIs to enter into basis swaps. However, APRA expects ADIs will not enter into transactions that from inception are, or are likely to become, loss-making. APRA considers such a scenario inconsistent with the current APS 120 and the principles that will apply in the proposed framework. Originating ADIs should ensure that securitisations 'pay their own way' and do

not receive artificial support from basis swaps or other enhancements. Basis swaps should not be structured such that an originating ADI is expected to become a net payer, and hence contribute to the on-going funding costs of the SPV.

If an ADI becomes or projects that it will become a net payer under a basis swap, the total negative cash flow must be deducted from CET1. APRA may consider further capital charges over and above the maximum capital charge should an ADI artificially support the SPV.

APRA will propose further guidance about projecting cash flows in basis swaps in the revised *Prudential Practice Guide APG 120 Securitisation* (APG 120).

## Spread accounts and similar surplus income arrangements

Where an originating ADI transfers assets to a SPV, it may be entitled to the future surplus income generated by a securitisation. This income may take the form of excess spread.<sup>36</sup> Where an originating ADI provides funds to establish a spread, reserve or similar account, those amounts must be deducted from CET1 until the funds are irrevocably paid to the ADI. APRA intends to continue this requirement.

APRA does not intend that an originating ADI may, from inception of a securitisation, increase a retained first-loss position or credit enhancement, regardless of whether the securitisation is for funding-only or capital relief purposes. Excess spread arrangements established or amended after the inception of a securitisation may effectively increase an ADI's retained first-loss position; this credit enhancement should only be provided to the extent required to cover any new exposures in the pool.

<sup>34</sup> While variable interest rate home loans are common in the Australian market they are less common in other jurisdictions.

<sup>35</sup> Threshold rate mechanisms require that the interest rate set on the loans assigned to the SPV generates, in aggregate, sufficient income for the SPV to meet its obligations. They are ordinarily activated only where there is a pre-defined event such as the retirement of the swap provider, through default, a ratings downgrade or some other inability to perform. Clauses in trust documentation also frequently require that the interest rates on the loans in the relevant pool are the same as the rates on comparable loans that the originating ADI has not securitised. The intention is that if the threshold rate is triggered the ADI must reprice its entire book.

<sup>36</sup> Excess spread is defined as finance charge collections and other fee income received by the SPV net of costs, interest and expenses.

However, APRA's proposed framework is not intended to capture an existing structural arrangement that is available to cover losses in the scheme. In some cases, structures incorporate an 'excess spread trap', a spread account that traps the excess spread within the SPV up to a specified amount or under certain defined circumstances. Where an excess spread trap is established at inception, the originating ADI does not provide funding to increase the position on an on-going basis.

APRA intends to clarify its treatment of excess spread arrangements in the revised APG 120.

## Repurchase or replacement of exposures out of the pool

The current APS 120 permits an originating ADI to repurchase exposures from an SPV so that it can grant a further advance to a borrower or for a similar purpose. This may occur as the ADI remains the lender of record and retains the customer relationship. The intention of this provision is to facilitate an ADI's ability to respond to customer-initiated transactions that are not problematic credits. Similarly, an originating ADI may repurchase exposures from an SPV as a result of a breach of representation or warranty. A 120-day period is viewed as sufficient to allow the trustee of the SPV time to undertake appropriate due diligence on the pool and replace non-complying assets.

A warehouse SPV is intended to support a specific term securitisation structure or, potentially, a series of term securitisations. To ensure that the warehouse seamlessly rolls into the term structure, it is appropriate that representations and warranties for both the warehouse and the term securitisation are negotiated at the outset (so the issue of assets being ineligible for the term issuance structure would not normally arise). This would include assignment of the benefit of the original representations and warranties.

APRA does not intend that an originating ADI would substitute assets in securitisations as a matter of course. For both funding-only and capital relief securitisations, APRA proposes to maintain the existing requirements that any repurchase or replacement of exposures to fund further advances to a borrower or a similar

purpose must be on market terms and conditions and not include defaulted exposures.

APRA proposes to continue to require any repurchase or replacement of exposures for breach of representation or warranty to be completed within 120 days of transfer and conducted on the same terms and conditions as the original transfer. An ADI would have full discretion to deal with a breach of representation or warranty but should not be under any requirement to automatically repurchase the asset. Instead, the ADI would determine the most appropriate course of action at the time the breach of representation or warranty is identified. APRA proposes to apply this treatment equally to funding-only and capital relief securitisations.

Whether a warehouse is for funding-only or for capital relief, APRA proposes that the originating ADI only restate the representations and warranties given to a warehouse to the term issuance structure, i.e. an assignment of the original representations and warranties.

## Unfunded support

The current APS 120 prohibits an ADI from using an external credit assessment for risk-weighting a securitisation holding where the assessment is at least partly based on unfunded support, e.g. a liquidity facility or credit enhancement provided by the ADI itself. This prohibition was introduced by the Basel Committee as part of its *Enhancements to the Basel II Framework* to address behaviour witnessed during the crisis.<sup>37</sup> The reference to 'support' can be read broadly as not being limited to credit protection and could include support in the form of swaps or liquidity facilities that do not provide credit protection to a securitisation exposure.

<sup>37</sup> The Basel Committee noted that during the crisis several originating banks that provided a liquidity facility to ABCP programs chose to purchase commercial paper issued by the ABCP conduit instead of having the conduit draw on its liquidity facility. The liquidity facility provider then risk-weighted the ABCP based on the commercial paper's external rating. As a result, the Liquidity facility provider benefited from the external rating on the commercial paper when assigning a risk-weight to that paper, even though the rating was due in large part to its own support of the conduit in the form of the liquidity facility. The full text of this document is at <http://www.bis.org/publ/bcbs157.htm>.

APRA has received feedback that this prohibition is unnecessarily restrictive and applies too broadly. The assessment of whether an ADI is providing unfunded support should, it is argued, take into account the economic substance of that support in the context of the overall transaction and any circumstances where the ADI could become exposed to a higher credit risk in the absence of that support.

APRA proposes to maintain the existing prohibition against using an external credit assessment for risk-weighting a securitisation holding where the assessment is at least partly based on unfunded support. This is to ensure there are no adverse incentives between ADIs and any self-guarantees provided.

APRA also proposes to revise APG 120 so that 'support' in this context will be interpreted from a substantive perspective. This would mean that certain swaps and liquidity facilities would not be considered 'support' for the purposes of this requirement. When considering whether a timing-mismatch liquidity facility constitutes 'support', it will be important to consider the amount involved and the length of time any mismatch is likely to last. Where the facility is materially relied upon for the purposes of the rating, APRA proposes to consider the facility to be 'support' for these purposes.

## Risk-weighting of underlying collateral and trust-back arrangements

Under the current APS 120, an ADI must have regard to the actual transaction structures in place in calculating the regulatory capital requirement under APS 112 or APS 113. In a securitisation, collateral is potentially transferred to the trustee of the SPV as trustee for the beneficiaries, i.e. the investors. If an ADI cannot demonstrate that it has unequivocal enforcement rights, it cannot 'look through' the SPV and apply a risk-weight of less than 100 per cent.

Some securitisations also feature 'trust-back' arrangements that enable an ADI to maintain a security interest for retained exposures, e.g. personal loans, where the underlying collateral has been equitably assigned to the SPV. In these circumstances, an ADI may benefit from any residual value in collateral left over after investors in the securitisation scheme have been paid out.

Under the current APS 120, where an ADI retains an interest in collateral assigned to an SPV as a result of additional exposures to that collateral, these exposures will not be eligible for a risk-weight of less than 100 per cent, unless there is a formal second mortgage arrangement in place.

In assessing whether claims are secured by relevant collateral under APS 112 and APS 113, APRA proposes that an originating ADI may treat the relevant pool as if the exposures in the pool were held by the ADI. This is to ensure that higher risk-weights do not apply for funding-only securitisations, as opposed to those risk-weights that apply as if the securitisation did not occur.

It is not always clear with trust-back arrangements that trustees with obligations to protect investors would necessarily seek to enforce the collateral to protect an ADI's personal loan exposures that are not part of the securitised pool of mortgages. To guard against this risk, APRA intends to maintain its long-standing policy position that a risk-weight of less than 100 per cent can only apply where there is a formal second mortgage in place to secure further advances to a borrower secured by a mortgage that has been securitised.<sup>38</sup>

<sup>38</sup> For self-securitisations, a formal second mortgage is not required to apply a risk weight of less than 100 per cent for additional exposures to collateral assigned to the SPV, until the securitisation is used to obtain liquidity from the RBA.

## Chapter 8 – Other issues

### Self-assessments

Under the current APS 120, ADIs are required to carry out written self-assessments of each securitisation in which they participate, and to submit these assessments to APRA upon request.

APRA proposes to continue this requirement, which applies to all levels of involvement in securitisation, not just to participation as an originating ADI. APRA expects each self-assessment to describe the methodology used to assess the exposures related to the securitisation, including the purpose of the securitisation. An ADI will need to establish through its self-assessment process that a securitisation complies with the revised APS 120, when finalised, whether the securitisation is funding-only or for capital relief.

### Prior consultation and APRA approval

The current APS 120 requires an ADI to notify APRA prior to entering into a funding arrangement, other than covered bonds issued consistent with the Banking Act or a capital relief securitisation, that involves providing an interest in or over assets originated by the ADI, to a funding provider. APRA has power to approve these arrangements in exceptional circumstances.

Since the revised APS 120 will explicitly recognise funding-only securitisations, APRA proposes not to require an ADI to notify or seek APRA approval for a funding-only securitisation that meets all relevant aspects of the revised APS 120.

### Consequences of non-compliance

Under the current APS 120, APRA has a range of rectification powers and penalties to address non-compliance with the standard. These include:

- APRA *may*, in writing, increase the capital requirement for an originating ADI if it considers that the ADI is providing implicit support or otherwise not complying with the standard. This may include an increase in the capital charge on the ADI's total securitisation business, not just the securitisation for which implicit support is provided;

- where an ADI is providing implicit support, APRA *may* require the ADI to disclose publically the implicit support; and
- APRA *may* impose quantitative and qualitative limits, including prohibiting further securitised issues, on the extent to which the ADI may securitise additional exposures or acquire additional securitisation exposures, including those arising from providing facilities and services.

Currently, the general adjustment and exclusion power, which allows APRA to adjust or exclude a specific requirement in the standard in relation to a particular ADI, is not captured within APS 120.

APRA proposes to continue to prohibit implicit support, but to amend APS 120 to require an ADI that breaches the prohibition, at a minimum, to hold regulatory capital against all of the exposures associated with the securitisation as if they had not been securitised. In these circumstances, APRA proposes to require an ADI to publically disclose the support. This is to align more closely with the Basel Committee's requirements.

APRA also proposes to include the general adjustment and exclusion power in the revised APS 120, in addition to the remaining existing rectification powers and penalties. APRA envisages that this power would be used sparingly given its preference for simple structures.

APRA also proposes to amend APS 120 so that, where relevant, APRA may request the external auditor, or an appropriate external expert, to provide an assessment of an ADI's securitisation activities. Such reports would be paid for by the ADI and made available to APRA upon request.

APRA's broader supervisory powers for ADIs include the ability to increase capital through a Pillar 2 adjustment.<sup>39</sup> ADIs demonstrating poor compliance or controls in securitisation may attract a Pillar 2 adjustment, as well as any more direct limits on securitisation arrangements.

<sup>39</sup> Refer to paragraph 22 of *Prudential Standard APS 110 Capital Adequacy*. APRA may, in writing, determine higher prudential capital requirements (PCRs) for an ADI and may, in writing, change an ADI's PCRs at any time.

## Consequential amendments to other prudential standards

APRA anticipates that there are likely to be consequential amendments to other ADI prudential standards as a result of the proposed simplification of APS 120. APRA will consult on these amendments when it consults on the revised APS 120.

## Artificiality and gaming

As with most other aspects of APRA's prudential framework, ADIs have generally sought to undertake securitisations on a basis that is clearly within the framework. At times, however, APRA has had to deal with attempts to push the securitisation framework beyond its intended application.

The proposals set out in this Discussion Paper are intended to make APS 120 more principles-based and less rules-based. In taking this approach, APRA considers that ADIs will find ample opportunity to pursue both funding-only and capital relief securitisations, without any need to seek unduly 'creative' applications of the revised framework. APRA will respond to any unsatisfactory application of the new framework via Pillar 2 capital increases or other supervisory interventions.

# Chapter 9 – Reporting requirements and transitional arrangements

## Reporting requirements

APRA's proposed securitisation reforms will require an update to certain aspects of its reporting framework. APRA will consult separately on the relevant reporting standards.

With the proposed introduction of credit risk retention requirements, APRA considers it appropriate for prudential reporting purposes that the originating ADI report the SPV on its balance sheet. This would require an adjustment on the capital return to credit risk-weighted assets for capital relief securitisations.

Liquidity reporting will be subject to its own regulatory reporting requirements (see Chapter 5).

APRA also intends to release for consultation proposed reporting requirements for covered bonds when it releases the revised reporting requirements for APS 120.

## Transitional arrangements

APRA is conscious that there may be cost and effort involved in amending existing structures, particularly for securitisations that meet the operational requirements for regulatory capital relief under the current APS 120.

APRA does not propose to require ADIs to amend and reissue existing securitisations to comply with all aspects of the revised standard. However, it does not propose to 'grandfather' these structures.

APRA's proposed transitional arrangements are as follows:

- new transactions – any transactions entered into after the effective date of the revised APS 120 must comply with the standard;
- existing term securitisations – where an ADI has met the operational requirements for regulatory capital relief under the current APS 120, the ADI will be able to transition the structure to the 10 per cent clean-up call;

- existing securitisations including those subject to the alternative capital treatment – where an ADI has entered into a funding arrangement that has been approved by APRA, APRA may consider the impact on the ADI of including all the underlying assets on its balance sheet. Where this impact is significant APRA may consider allowing the ADI to continue the deduction approach until the end of a two-year transition period. Where a securitisation is already treated as on-balance sheet for regulatory capital purposes, the ADI will be expected to run-off the structure;
- existing securitisations terminating within 12 months – where a securitisation will terminate, mature or be wound up, or where it may be renewed or cancelled within 12 months, the transition period will start on the effective date of the revised standard and end on the earliest possible termination, cancellation or maturity date; and
- where an ADI would attract a CET1 deduction for holding subordinated classes of another issuer's securitisation, APRA does not intend to grant transition relief for assets which can be sold in an orderly fashion. ADIs holding subordinated classes for which there is no orderly market may apply for transition relief. Any such application must demonstrate that the asset held is properly provisioned for its illiquid and (very likely) impaired status.

## Timeline and proposed release dates

APRA plans to release a response to submissions on this discussion paper and a draft revised APS 120, as part of a second consultation package in the first half of 2015.

APRA does not intend to finalise any reforms to its prudential framework for securitisation until, at least, the completion of the Financial System Inquiry now underway. APRA will also have regard to the proposed revisions to the securitisation framework of the Basel Committee, which have been out for consultation since December 2013.

## Chapter 10 – Request for cost-benefit analysis information

To improve the quality of regulation, the Australian Government requires all proposals to undergo a preliminary assessment to establish whether it is likely that there will be business compliance costs. In order to perform a comprehensive cost-benefit analysis, APRA welcomes information from interested parties on the financial impact of the changes proposed and any other substantive costs associated with the changes. These costs could include the impact on balance sheets, profit and loss, and capital.

As part of the consultation process, APRA also requests respondents to provide an assessment of the compliance impact of the proposed changes. Given that APRA's proposed requirements may impose some compliance and implementation costs, respondents may also indicate whether there are any other requirements associated with securitisation that should be improved or removed to reduce compliance costs. In doing so, please explain what they are and why they need to be improved or removed.

Consistent with the Government's approach, APRA will use the methodology behind the Business Cost Calculator (BCC) to assess compliance costs. The BCC is designed to capture the relevant costs in a structured way, including assessment of upfront costs and ongoing costs separately. The BCC is available at: <http://www.dpmc.gov.au/deregulation/obpr/bcc/index.cfm>. Respondents are requested to use the BCC methodology to estimate costs to ensure that the data supplied to APRA can be aggregated and used in an industry-wide assessment.



Telephone  
1300 55 88 49

Email  
[info@apra.gov.au](mailto:info@apra.gov.au)

Website  
[www.apra.gov.au](http://www.apra.gov.au)

Mail  
GPO Box 9836  
in all capital cities  
(except Hobart and Darwin)