



Prudential Practice Guide

APG 120 – Securitisation

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About this guide

Prudential Standard APS 120 Securitisation (APS 120) sets out APRA's requirements in relation to the involvement of authorised deposit-taking institutions (ADIs) in securitisation. This prudential practice guide aims to assist ADIs in complying with those requirements and, more generally, to outline prudent practices in relation to securitisation.

Subject to the requirements of APS 120, ADIs have the flexibility to configure their risk management framework for securitisation in the way most suited to achieving their business objectives.

Contents

Scope and definitions	5
Risk management requirements	5
Self-assessment	7
Most senior exposure	8
Significant credit risk transfer	8
Cross-holding of securities	9
Quantitative and qualitative limits on securitisation activity	9
Implicit support and other risks	9
Operational requirements for the use of external credit assessments	10
Financial and operational independence	10
Representations and warranties	13
Treatment of warehouse structures	13
Treatment of resecuritisation exposures	14
Information on the underlying collateral supporting securitisation exposures	14
Credit enhancements	14
Repurchase of exposures	15
Limit on purchases of securities	16
Funding facilities	16
Spread accounts and similar surplus income arrangements	17
Liquidity facilities	17
Disclosure	17
Cash collateral	18
Shared collateral and trust back arrangements	18

Scope and definitions

1. APS 120 specifically allows an originating ADI to provide a temporary warehouse facility that qualifies as an eligible facility. This concession is not available for a permanent warehouse facility, though an ADI that is not an originating ADI may provide such a facility, as an eligible facility, if it is provided to a structure that meets the definition of a securitisation and complies with the requirements of paragraphs 1 and 2 of Attachment E to APS 120.
2. The definition of securitisation generally requires multiple tranches in a structure. If a Special Purpose Vehicle (SPV) (other than a warehouse SPV) into which an ADI has originated assets does not meet this requirement, it is not eligible for capital relief under APS 120 and falls under the calculation of regulatory capital for credit risk under *Prudential Standard APS 112 Capital Adequacy: Standardised Approach to Credit Risk* (APS 112) or *Prudential Standard APS 113 Capital Adequacy: Internal Ratings-based Approach to Credit Risk* (APS 113) as appropriate. In terms of APS 112 or APS 113, if an ADI is required to consolidate the SPV under accounting standards, the exposures must be included within the Level 1 and Level 2 capital calculation as appropriate under the Australian Accounting Standard.
3. In considering whether a conduit structure is a securitisation APRA intends that an ADI will look at the economic effect of the whole structure, rather than focus on the status of each SPV in the structure on a stand alone basis. Where, when considered in its entirety, a conduit structure is a securitisation APRA is prepared for the individual asset holding and funding SPVs to be treated as a securitisation (and as non-consolidated subsidiaries for the purposes of Attachment C to Prudential Standard APS 110 Capital Adequacy (APS 110)) even if they do not meet the multiple tranche test in their own right. APRA notes that, given the predominant structures used in the local market, it would generally consider a claim on a conduit structure that is a securitisation to be a resecuritisation exposure.
4. APS 120 applies to a group on both a Level 1 and Level 2 basis. Therefore, restrictions such as those applying to an originating ADI acquiring securities in an SPV or holding a material beneficial interest in an SPV or trustee are not intended to apply to non-consolidated subsidiaries (e.g. life insurers) acting on behalf of beneficiaries, if such activity occurs in the normal course of business and is in accordance with the entity's investment mandates and/or strategies.
5. However, if an originating ADI actively seeks to use a non-consolidated entity to circumvent the requirements of APS 120, APRA may consider such activity to constitute the provision of implicit support.

Risk management requirements

6. APS 120 requires an ADI to put in place policies and procedures related to securitisation. These policies should cover all aspects of APS 120 relevant to the ADI at both Level 1 and Level 2, including the due diligence process and the identification of capital requirements. This includes credit risk, concentration risk, market risk, operational risk, liquidity risk, legal risk and reputational risk. To help mitigate these risks a ADI's securitisation activities (both on and off balance sheet) should be included in all of an ADI's risk management disciplines such as product approval, risk concentration limits and estimates of market, credit and operational risk.
7. All risks arising from securitisation should be addressed in an ADI's Internal Capital Adequacy Assessment Process (ICAAP). These risks include:
 - (a) credit, market, operational, liquidity and reputational risk of each exposure;
 - (b) potential delinquencies and losses on the underlying securitised exposures;
 - (c) exposures from credit lines or liquidity facilities to SPVs; and
 - (d) exposures from guarantees and insurance provided by monolines (e.g. lenders mortgage insurers and credit wrap providers) and other third parties.

8. Securitisation exposures should be captured in the ADI's information and accounting systems to help ensure that senior management understands the implications of such exposures for liquidity, earnings, risk concentrations and capital. An ADI should have the necessary processes in place to capture in a timely manner information on securitisation transactions including market data, if available, and updated performance data from the securitisation trustee or service provider.
9. APRA expects an ADI to analyse the underlying risks when investing in a structured product and must not solely rely on external credit assessments. Where external assessments are utilised as an aid in the credit approval process, an ADI should fully understand and be comfortable with the methodology applied by the external assessor. An ADI should be aware that while external ratings are a useful starting point for credit analysis, they are no substitute for a full and proper understanding of the underlying risk, especially where ratings for an asset class have a short history or have been shown to be volatile.
10. APRA expects an ADI to conduct credit analysis of a securitisation exposure both prior to acquisition and on an on-going basis. It should have in place the necessary quantitative tools, valuation models and stress tests of sufficient sophistication to reliably assess all relevant risks. When assessing securitisation exposures an ADI should ensure that it fully understands the credit quality and risk characteristics of the underlying exposures in structured credit transactions, including any risk concentrations. In addition an ADI should review the maturity of the exposures underlying structured credit exposures relative to the issued liabilities in order to assess potential maturity mismatches.
11. An ADI should track credit risk in securitisation exposures at the transaction level and across securitisation exposures within each business line and across business lines. It should produce reliable measures of aggregate risk. An ADI should also track all meaningful concentrations in securitisation exposures, such as name, product or sector concentrations and feed this information to firm-wide risk aggregation systems that track exposures (e.g. credit) to a particular obligor.
12. An ADI's own assessment of risk needs to be based on a comprehensive understanding of the structure of the securitisation transaction. It should identify the various types of triggers, credit events and other legal provisions that may affect the performance of its on and off-balance sheet exposures and integrate these triggers and provisions into its funding/liquidity, credit and balance sheet management. The impact of the events or triggers on an ADI's liquidity and capital position should also be considered.
13. An ADI should consider scenarios which may prevent it from securitising assets as part of its stress testing and identify the potential effect of such exposures on its liquidity, earnings and capital adequacy.
14. APRA expects an ADI to have prudent contingency plans specifying how it would respond to funding, capital and other pressures that arise when access to securitisation markets is reduced. The contingency plans should also address how the ADI would address valuation challenges for potentially illiquid positions held by it. The risk measures, stress testing results and contingency plans should be incorporated into the ADI's risk management processes and its ICAAP.
15. An ADI that employs risk mitigation techniques should fully understand the risks to be mitigated, the potential effect of that mitigation and whether or not the mitigation is fully effective.

Self-assessment

16. APS 120 requires an ADI to undertake a written assessment for each securitisation in which it participates, demonstrating compliance with the requirements of the prudential standard. This applies to all securitisation transactions with an SPV, even when the ADI is merely a facility provider (e.g. a fixed interest rate swap provider) to a securitisation scheme. An ADI may decide the most appropriate format for the assessment. An assessment that considers each relevant requirement under APS 120 individually and clearly sets out references to supporting transaction documentation, policies and procedures, opinions and assessments will assist APRA's understanding of the ADI's compliance process. APRA would expect the assessment will be maintained on an ongoing basis, has regard to any changes in the standard or market practice, and to be signed off by senior staff from the ADI's securitisation and legal, compliance or risk management areas.
17. While APRA will obtain regular reporting on securitisation transactions under the ADI reporting framework, APRA will generally not review the assessments as they are made or in advance of issuance. However, a review may be undertaken in specific situations (e.g. if there are prudential concerns with an ADI's self-assessment practices or capacity to undertake self-assessments). Where an ADI is seeking to enter a securitisation transaction which contains features the ADI has not previously encountered it may wish to discuss the treatment of the securitisation exposure with APRA. APRA will, however, expect the ADI to forward its assessment of the issue and to highlight the specific area of uncertainty and APRA will rely on the information provided in forming its assessment. The ADI will need to ensure that all relevant details are provided as APRA reserves the right to reconsider the position should any additional relevant details subsequently come to light.
18. APRA envisages that its supervisors will request copies of a sample of self-assessments and the underlying transaction documentation when conducting prudential reviews of ADIs. For originating ADIs, this will generally be in the context of a credit risk review. However, where an institution has a book of market-rate related transactions with SPVs, significant holdings of SPV securities or significant liquidity lines to securitisation schemes, such a review may well occur in the context of a market risk or liquidity management review.
19. APS 120 requires the ADI's involvement with a securitisation to be set out in legal documentation, including legally enforceable contracts and investor documentation. APRA's expectation is that the key requirements relating to the securitisation will be set out in writing and that this written detail will form the basis of the documentation used in the self-assessment. APRA does not believe it is appropriate to rely upon verbal assurances, operational understandings or other undocumented information when an ADI assesses whether it will be in compliance with the requirements of APS 120.
20. APS 120 requires an ADI to consider the economic substance rather than the legal form in deciding the regulatory capital requirement for a securitisation exposure. APRA expects that each assessment will describe the capital methodology used for the exposures related to that transaction. APRA would not see it as appropriate for an ADI to take a mechanistic legal approach to assessing compliance; rather, staff with a detailed understanding of each specific transaction and its position within the broader securitisation structure would normally be involved.

21. APS 120 provides APRA discretion to require an ADI to seek a legal opinion on any of the separation and other operational requirements for capital relief. APRA would not expect to use these powers routinely. Instances where it might be considered appropriate to require a review include where there are concerns with the quality of the opinion provided in a self-assessment undertaken by the ADI, where unique or novel legal issues are raised by a particular transaction or structure, or where, through its supervisory activities, APRA has concerns that the requirements may not be met in practice.
22. APS 120 allows APRA to permit, in exceptional circumstances only, an ADI to enter into a securitisation exposure that does not meet all the compliance and operational requirements of APS 120. APRA will agree the appropriate capital treatment with the ADI.
23. Any contingent liquidity securitisation arrangements undertaken for repurchase agreements with the Reserve Bank of Australia, and which do not comply with the requirements of APS 120 as the ADI holds more than 20 per cent of the securities issued, will be able to be risk-weighted in accordance with the requirements of APS 112 or APS 113 as if the assets of the underlying pool were on the ADI's books.

Most senior exposure

24. Paragraph 6 of Attachment C to APS 120 provides an exception to the general treatment of unrated securitisation exposures i.e. an exception to deducting the exposure, where the exposure is the most senior exposure in the securitisation. The exposure is expected to be the most senior exposure at all times both pre-enforcement and post-enforcement. The seniority of the exposure must not change as a result of enforcement actions.

Significant credit risk transfer

25. Paragraph 18 of APS 120 and paragraph 2(d) of Attachment B of APS 120 requires an ADI to achieve significant credit risk transfer prior to being able to exclude the underlying assets from its calculation of risk-weighted assets. APRA has deliberately not specified any quantitative thresholds and as such an ADI is required to use its judgement as to whether it believes that the principle of there being a significant risk transfer has been met. APRA would expect an ADI to consider the proportion and the risk position of any securities it holds from the securitisation as part of this assessment. APRA believes it would be difficult to justify a significant credit risk transfer if an ADI held the majority of the lower grades of securities issued by the SPV (even if rated) particularly where there is not a first loss credit enhancement tranche in place (held by a third party) that absorbs losses from all sources. APRA does not consider it appropriate for an ADI to assume that just because the structure complies with all other requirements of APS 120 that there has been a significant credit risk transfer.
26. In APRA's view, originating ADIs holding the most subordinated tranche(s) of a securitisation have retained a substantial majority of the credit risk in the transaction. In particular, APRA does not accept:
 - (a) lenders mortgage insurance on the underlying loans in the securitisation structure;
 - (b) excess spread available to absorb losses ahead of the most subordinated tranche; and/or
 - (c) holdings of subordinated tranche(s) being less than the 20 per cent threshold referred to in APS 120 Attachment F paragraph 8(c),
 as adequate justifications that significant credit risk has transferred to third parties.

27. Paragraph 2 of Attachment B of APS 120 links to the requirements of Attachment C of Prudential Standard *APS 110 – Capital Adequacy*. If an ADI does not meet the requirements of paragraph 2 then under Attachment C of APS 110 it must continue to treat the exposures sold to the SPV as being part of the operations of the ADI.

Cross-holding of securities

28. The key principles in APS 120 require ADIs to deal with a special purpose vehicle and its investors on an arm's-length basis and on market terms and conditions. APRA will not take a favourable view of originating ADIs entering into bilateral, or multilateral, arrangements to purchase the subordinated tranche(s) of other ADI-originated securitisations. Should this occur, APRA will reconsider the capital treatment applicable to subordinated tranches.

Quantitative and qualitative limits on securitisation activity

29. APS 120 paragraph 23 provides that, in certain circumstances, APRA may impose quantitative or qualitative limits on an ADI's securitisation activities. Such restrictions could include:
- (a) prohibiting an ADI from undertaking further securitisation activity until the Board of Directors and senior management of the ADI can establish they have an appropriate understanding of the ADI's securitisation structures, activities and exposures;
 - (b) prohibiting an ADI from undertaking specific securitisation activity until the ADI can establish that it has the capacity to undertake a detailed and effective self assessment of its activity;
 - (c) prohibiting the ADI from undertaking further activity until the ADI has developed adequate policies and procedures to govern its securitisation activity;

- (d) imposing a limit on the value of an ADI's securitised loan book (e.g. based on its balance sheet) where it is considered to rely excessively on securitisation to fund its lending operations; and
- (e) prohibiting an ADI from seeking to wind up, or accelerate the wind-up, of a securitisation structure, in a manner inconsistent with the standard.

Implicit support and other risks

30. APS 120 requires that an ADI must not provide, or knowingly allow the perception to arise that it will provide, support to a securitisation in excess of the ADI's explicit contractual obligations. To do so will be to provide implicit support. In addition, the Board of directors and senior management must put policies and procedures in place that outline how the ADI will ensure it is not providing implicit support for a securitisation.
31. APRA's intent is that each ADI be responsible for ensuring that its transactions are not structured and, equally importantly, its ongoing operations are not carried out, in a way that gives the impression that the ADI supports the securitisation over and above any explicit contractual requirements.
32. APRA envisages that ADIs will develop risk management policies and procedures for their ongoing securitisation activities. These would be designed to provide assurance that an ADI is complying with its contractual obligations and, where it seeks to depart from these, to ensure that there is an appropriate review procedure in place to ensure that the departure could not be seen as giving rise to implicit support (or to otherwise breach requirements of APS 120).
33. Examples of situations that might be seen as providing implicit support include:
- (a) an originating ADI regularly or systematically refinancing or restructuring lower quality loans in a pool so that they are eligible to be repurchased by the ADI;

- (b) an originating ADI making an indemnity or other payment or accepting a lower fee or reduced charge in lieu of passing on a full increase in a required or threshold rate;
 - (c) an originating ADI purchasing the assets held in an SPV to allow the SPV to avoid making a formal draw on a liquidity facility;
 - (d) an ADI actively seeking to refinance loans it originated into an SPV where the required rate/threshold rate arrangement is above its normal lending rate for similar non-securitised loans or materially above the general market rate for such loans;
 - (e) an ADI entering into a facility to purchase assets from an SPV at above market rates (e.g. via a liquid asset purchase agreement or a market value agreement);
 - (f) an ADI purchasing assets held in an SPV or securities issued by an SPV at above market rates;
 - (g) providing funding to a party to enable it to exercise a clean-up call option (e.g. dated call) that the ADI is not permitted itself to exercise directly;
 - (h) exercising a clean-up call option that acts as a credit enhancement; or
 - (i) providing facilities or services or holding SPV securities via non-consolidated subsidiaries, outside the scope of their normal investment activities, that the ADI (or its Level 2 entities) would not be permitted to provide or hold directly.
34. If APRA assesses that an ADI has provided implicit support to a securitisation vehicle it may impose capital penalties commensurate with the risk of the provision of support. Each situation will be assessed individually with the circumstances, motivations and means of discovery of the support taken into consideration, amongst other factors when deciding APRA's response.

Operational requirements for the use of external credit assessments

35. APS 120 Attachment B paragraph 11 requires an ADI to apply the external credit assessments of an ECAI consistently across a given type of securitisation exposure. Where there is a difference in credit rating across rating agencies then the relevant provisions of Attachment E of APS 112 apply. In addition, an ADI must not use the external credit assessment issued by one ECAI for some tranches and those of another ECAI for other tranches within the same securitisation. APRA is aware that recently the situation has arisen, in certain structures, where one ECAI has rated a number of tranches of notes (and/or other exposures) and another ECAI has rated fewer tranches (and has either not been asked to or has chosen not to rate the other tranches or exposures). This is against the intention of APS 120 that there be no cherry picking involved in the use of ECAs and that ECAs are used by the SPV on a consistent basis. In these situations, APRA would expect the ADI to presume that the exposures not rated by the second ECAI have effectively been assigned a rating of unrated and so must assign capital to those exposures actually rated only by one ECAI as if they were unrated.

Financial and operational independence

36. APS 120 requires a securitisation SPV to be financially and operationally independent of the originating ADI. This reflects APRA's view that a securitisation is more than a mere funding mechanism. It is envisaged as an arrangement where the underlying pool of exposures is sold to an SPV, with the intention that the underlying exposures will not return to the originating ADI other than in very limited circumstances.

37. APRA envisages that the SPV would normally provide funding for the full life of the underlying pool without reliance on the originating ADI should there be problems in arranging funding. In addition, APRA envisages that the SPV, consistent with being the owner of the assets, would normally exercise all rights and obligations with respect to the assets on its own behalf without undue regard for the interests of the originator of the assets in the pool. Also, as the independent owner, the SPV's ongoing operations and fortunes should not be tied to those of either the originator or sponsor and it should have an ability to distance itself from the originating ADI.
38. The financial and operational independence of the SPV would normally be reflected in the following features:
- (a) the SPV could continue to exist and operate as the owner of the pool of assets even if the ADI withdraws (subject to meeting its contractual obligations) its active support for the SPV;
 - (b) a default or a ratings downgrade of the originating ADI would not of itself constitute an event of default on the SPV's securities; and
 - (c) the financial position of the SPV does not depend on the financial standing or rating of the originating ADI.
39. APRA does not expect an SPV, in the ordinary course, to have its own staff or operational infrastructure. An SPV might outsource its operations, subject to normal arm's-length outsourcing arrangements, to the originating ADI or another party. However, the SPV would usually need to have a governance structure and access to sufficient staff, data, operational infrastructure and systems, amongst other factors, to enable it to continue operating if, for whatever reason, an originating ADI is not able to provide a service.
40. Such situations could include where the ADI:
- (a) decides to withdraw from or wind down all or part of its securitisation activities;
 - (b) decides to exercise a right to terminate facility and service agreements;
 - (c) is subject to a credit rating downgrade;
 - (d) goes into administration or liquidation; or
 - (e) seeks to sell a subsidiary that provides services (e.g. a manager or servicer).
41. A key principle of APS 120 is that an ADI must deal with an SPV and its investors on an arm's-length basis and on market terms and conditions. APRA views this as a two-pronged test under which an ADI would generally be able to demonstrate that:
- (a) its dealings with an SPV (and its investors) are on the same contractual basis as it would ordinarily use for dealings with an independent 'third-party' SPV (and its investors); and
 - (b) the terms and conditions are broadly equivalent to those under which an independent third party would offer to transact.
42. An ADI is required to obtain a written advice from legal counsel that the exposures transferred to the securitisation vehicle are beyond the reach of the ADI and its creditors, including in the case of a statutory manager being appointed or its winding up and receivership. Where loans are equitably assigned, but are subject to a title perfection event, APRA expects that this legal opinion will cover the situation where the appointment of an ADI statutory manager occurs before title can be perfected. In addition this opinion should also canvass the impact of the appointment of a statutory manager on any cash collateral and similar arrangement related to the securitisation which gives rise to an asset on the ADI's balance sheet.

43. Where it is not feasible for an independent third party to quote a rate for conducting the transaction (e.g. a basis swap), it would be difficult, in APRA's view, to establish that the deal is on 'an arm's-length basis and on market terms and conditions'.
44. An originating ADI's self-assessment of the compliance of its basis swaps with the requirements of Attachment E to APS 120 (and its approach to valuing such swaps for APRA reporting purposes) will be a particular area of focus in APRA's securitisation reviews. APRA recognises that many basis swaps are inherently non-arm's length. APRA will also seek comfort that a basis swap does not provide credit support, liquidity or other funding to an SPV. Basis swaps also need to be assessed in the context of an ADI's asset-liability and interest-rate risk management policies, including consideration of the need to hedge these exposures.
45. Under APS 120, APRA may require an ADI to deduct the net present value of a derivative transaction from capital where the ADI is or expects to be a net payer for an extended period of time. APRA would not envisage exercising this power where the ADI is already passing the swap revaluation through its profit and loss account for APRA reporting purposes.
46. Attachment E to APS 120 states that a facility or service does not need to specify a fixed termination date provided the ADI has the right, at its absolute discretion, to withdraw from its commitments at any time following a reasonable period of notice.
47. This reinforces the notion of the financial and operational independence of the SPV and is designed to ensure an ADI has the capacity to promptly and effectively distance itself from an SPV should it choose to do so. While APS 120 does not set a fixed time limit, APRA has typically considered 90 days to be a reasonable maximum period of notice.
48. APRA does not consider that making retirement from a facility or service dependent on the appointment of an alternative facility or service provider to be consistent with an ADI being able to withdraw at its absolute discretion. Similarly, the need for an ADI to post collateral for, or the right for an SPV to draw on, a facility in the event of the ADI's retirement would not generally be considered to be consistent with the right of an ADI to withdraw at its absolute discretion. This reflects the fact that, in substance, the ADI retains the economic risk of providing the facility, which is inconsistent with the intention that the risk lapses or ceases at the end of the notice period (other than where a facility has already been drawn in accordance with its terms and conditions and repayment is still outstanding).
49. Attachment E to APS 120 requires that, in specified circumstances and subject to reasonable qualifications, the SPV and/or investors must have the express right to select an alternative party to provide the facility/service.
50. APRA's intention is that an ADI not seek to entrench itself as a facility or service provider to an SPV. Indeed, consistent with an SPV being financially and operationally independent from the originating ADI, the SPV should have an ability to distance itself from the ADI, if the SPV considered it necessary to do so. Where the SPV has a contractual right to exit the arrangement, it should also not be unduly restrained in the choice of an alternative facility or service provider.
51. APRA expects an ADI to undertake its own assessment of the reasonableness of the restrictions that apply to the SPV's ability to seek an alternative facility and service provider. It is expected that an ADI would compare the restrictions both to other securitisation schemes (particularly those involving other ADIs) and also to its non-securitisation dealings. For example, an ADI might compare the restrictions on the SPV seeking an alternative (non-basis swap) derivative provider and the consequences (e.g. break fees) of doing so with the terms in derivatives deals with non-securitisation SPVs and also corporate counterparties.

52. Examples of terms that might not be considered reasonable qualifications include:
- (a) a requirement that the SPV must not appoint a competitor to the ADI to provide the facility or service; and
 - (b) a requirement that replacement can only occur if a fraud has been perpetrated.
- (d) who ultimately approved the action taken; and
 - (e) the rectification action being taken to prevent further breaches;
56. APRA may also seek additional information so as to satisfy itself that the requirements of the standard have been complied with and that the arrangement cannot be seen to have given rise to implicit support.

Representations and warranties

53. Attachment F to APS 120 deals with compensation for a breach of any representation or warranty given by an ADI to an SPV. Aside from the circumstances covered in paragraph 6 of Attachment F, APRA intends that an ADI retain full discretion as to how it should rectify a breach of a representation or warranty. In particular it must not have any obligation to, and there must be no expectation that it will, automatically repurchase exposures to rectify a breach.
54. Where a breach is identified, the ADI should identify the remedial action necessary to prevent future breaches of a similar nature. APRA expects the ADI to decide the most appropriate manner to rectify the breach whether that be the payment of damages (which must not exceed a reasonable estimate of the loss suffered by the SPV) or the reassumption of credit risk of the exposure. In the latter case, APRA's expectation is that this will generally be done in a manner that leaves the exposure within the SPV (e.g. via a guarantee). Consistent with the separation of the ADI and SPV as well as the need for financial and operational independence, an outright repurchase should be viewed as a last resort in those cases where no other option is considered practical or effective.
55. Where an ADI is required to notify APRA about the payment of damages or the reassumption of credit risk this notice should include an outline of:
- (a) the circumstances behind the breach;
 - (b) the response to the breach;
 - (c) what alternatives were considered (e.g. damages versus reassumption of risk, how damages were quantified, why reassumption of the risk was agreed and how the particular manner of reassuming risk was chosen);

Treatment of warehouse structures

57. The expectations of term funding referred to in paragraphs 36 and 37 above, are particularly relevant to warehouse SPV funding arrangements. An ADI selling exposures into a warehouse SPV needs to carefully consider the implications, should the warehouse SPV not roll over to a term securitisation prior to the expiry of the warehouse funding line. In particular, the ADI runs the risk that the warehouse funder may perfect its title in the pool and sell the exposures to a third party who may seek to service the exposures. APRA does not have the discretion, or the inclination, to permit the ADI to repurchase the pool from the warehouse SPV.
58. APRA will consider any active role played by the ADI to facilitate the refinancing of the warehouse SPV, other than through the originally anticipated term securitisation issue, either by the original lender rolling over the warehouse facility or by an alternative funding provider to be the provision of implicit support.
59. Examples of situations that might be seen as providing implicit support to a refinancing warehouse SPV include the ADI:
- (a) providing new or additional representations and warranties in respect of the pool (or refreshing representations and warranties in such a manner that means the ADI is responsible for changes in the pool composition or quality since the exposures were originally sold into it);

- (b) taking action to rebalance the pool e.g. repurchasing loans that the alternative funder does not wish to acquire;
 - (c) providing additional credit enhancements or support to the pool;
 - (d) providing any additional finance to the pool e.g. by purchasing units or securities issued by the new SPV (or previously held by another party in the case of a roll-over of the structure); or
 - (e) reducing the cost of facilities and services provided to the pool (unless it can clearly be shown to reflect changes in market rates).
62. APRA would expect that a similar level of detail is available, for each of the pools that underlie the securitisation exposures, which result in an exposure being considered a resecuritisation.
63. The ADI must ensure that the information it has access to on an on-going basis is collected, reviewed and assessed on a regular basis in a timely manner. The ADI should put in place policies establishing the review cycle for all types of securitisation exposures, which includes triggers for more intensive or more regular reviews of exposures.

Treatment of resecuritisation exposures

60. APRA expects an ADI to treat as a resecuritisation claims on a pool that is permitted to invest excess cash in authorised investments which can include securitisation exposures. 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, then it may regard the claims as securitisation exposures.

Information on the underlying collateral supporting securitisation exposures

61. Attachment B to APS 120 requires an ADI to deduct a securitisation exposure where it does not perform an adequate level of due diligence. As part of this due diligence, an ADI must be able to access detailed performance information on the underlying pools on an ongoing basis in a timely manner. APRA expects that such information may include, as appropriate: exposure type; percentage of loans 30, 60 and 90 days past due; default rates; prepayment rates; loans in foreclosure; property type; occupancy; average credit score or other measures of creditworthiness; average loan-to-value ratio; and measures of industry and geographic diversification.
64. APRA's expectation is that the size of a first loss credit enhancement will be such that (if it were rated) any second loss credit enhancement supported by the first loss facility would be considered the equivalent of investment grade (i.e. BBB- or above). This is reflected in the provisions of paragraph 10 of Attachment C to APS 120.
65. In calculating the appropriate multiple of historical losses, APRA expects an ADI to consider all relevant sources of risk including the type of assets in the pool, downturn or stressed loss rates and historical volatility in losses. Where an ADI relies on a rating agency to determine the size of the first and second loss credit enhancements, it will need to be comfortable that the methodology used adequately reflects any risk of additional losses due to idiosyncratic or specific characteristics of assets in the pool (e.g. special clauses in loan documentation, undertakings made to the borrower when originating loans and unusual concentration of borrowers).

Credit enhancements

66. The operational requirements for regulatory capital relief set out in Attachment B to APS 120 prohibit the originating ADI from increasing a retained first loss position or credit enhancement. This is not intended to capture a structural arrangement, such as a surplus income arrangement, that is available to cover losses in the scheme. In this situation, the ADI does not provide funding to increase the position, and it cannot recognise for regulatory reporting purposes any income that may arise from its entitlement until it is irrevocably earned.
67. A first loss credit enhancement is generally considered to be immediately available to absorb losses unconditionally in all circumstances in the first instance. Enhancements where there is a process to recover the losses, and the provider has the opportunity to deny the application are not considered first loss credit enhancements as they are not unconditional.
70. Examples of situations that could be seen as similar purposes include:
- (a) a change in the interest rate basis of the loan (e.g. moving from a floating rate to a fixed rate);
 - (b) a change in the interest rate structure (e.g. from an amortising loan to an interest-only loan);
 - (c) a change in the loan structure (e.g. moving from a full-documentation to a low-documentation loan); and
 - (d) a change in/substitution of the mortgage security.
71. While it is considered appropriate to accommodate these sorts of arrangements, APRA does not wish to see the provisions used in such a way as to routinely or systematically transfer doubtful or lower quality exposures in the pool back to the originating ADI or to accelerate the winding down of the pool (which would likely amount to implicit support).

Repurchase of exposures

68. APS 120 places restrictions on the ability of an originating ADI to enter into a clean-up call. APRA does not intend this restriction to extend to call options entered into by another trust or entity (outside the ADI's Level 2 group), provided the originating ADI does not facilitate that entity's funding of the exercise of the call option. Similarly, APRA does not intend to prevent the call option being entered into by a non-consolidated subsidiary of the originating ADI (e.g. a life insurer) on behalf of its beneficiaries, in the normal course of business and consistent with its investment mandates and/or strategies.
69. APS 120 permits an originating ADI to repurchase exposures from an SPV if the repurchase is to grant a further advance to the borrower or similar purpose. This need may arise as the ADI remains the lender of record and retains the customer relationship and so has the legal obligation to the customer. The intent is that this provision facilitates an ADI's ability to respond to customer-initiated transactions that may make the loan ineligible under the SPV's criteria to remain in the pool.
72. In particular, APRA would not expect an originating ADI to make a general offer to refinance (prior to scheduled maturity) its customers' loans held in a pool. Rather, APRA would expect customers to initiate the transactions in the normal course of meeting their banking requirements.
73. APRA would generally not expect an ADI to exercise a call option when this would result in it acquiring assets of an SPV which were offered for sale to a third party (including another SPV) and the third party declined to acquire them. For example, where a third party holds a call option over the pool (or part thereof) and exercises it then APRA would not expect the ADI to subsequently exercise its call option to acquire any assets that remain in the SPV after the exercise of this option. Prima facie such an arrangement is seen as being structured to avoid allocating losses to credit enhancements or positions held by investors (by facilitating the accelerated wind up of the SPV) and so is inconsistent with APS 120 Attachment F paragraph 3(b).

Limit on purchases of securities

74. Attachment F to APS 120 limits an originating ADI to a 20 per cent holding in securities issued by an SPV. Attachment E to APS 120 permits an ADI to acquire 100 per cent of the securities on issue if it is providing an underwriting facility to the securitisation. These securities must be sold down and the ADI hold less than 20 per cent of the securities outstanding within three months. The 20 per cent limit in Attachment F is intended to allow the ADI to undertake modest market making activities in the securities issued by the securitisation vehicle. APRA intends that the limit applies throughout the life of the scheme (including the situation where a clean-up call that is built into the structure is not exercised) and is measured on a consistent basis (e.g. par value or market value). An ADI will therefore need to monitor this limit where the tranches it holds amortise or repay at a slower rate than the average for all securities issued by the SPV.
75. In its self-assessment, an originating ADI is expected to outline the policies and procedures in place to:
- (a) Monitor its holdings against the 20 per cent limit (including the valuation basis to be used); and
 - (b) Ensure that it takes timely action to reduce its holdings prior to a breach of the limit occurring.
76. APS 120 requires that a funding facility provided by an originating ADI (other than a temporary funding facility provided during the establishment phase of a securitisation) does not fund a disproportionate amount of the pool of the SPV at any time during the life of the securitisation. Consistent with facilities being on an arm's-length basis and market terms and conditions, APRA expects that an originating ADI's assessment of 'disproportionate' would take into account factors such as:
- (a) the nature of the facility;
 - (b) its intended use;
 - (c) its intended run-off/resizing over the life of the pool; and
 - (d) the normal level of similar facilities in other ADIs' securitisation schemes.
77. For example, where an originating ADI is providing a redraw funding facility to a scheme (which is not being assessed as a revolving credit securitisation under APS 120), APRA would expect a relatively low limit to be in place and the limit to reduce in amount as the pool reduces.
78. In general, consistent with the threshold for purchasing and holding securities issued by an SPV, APRA expects that the aggregate amount of funding facilities would not exceed 20 per cent of the value of the pool at a point in time. APRA would, however, expect that an ADI in its self-assessment would assess what amount would be considered disproportionate in light of each individual facility, rather than adopting a simple numeric cap.
79. Operationally many managers and administrators of securitisation vehicles fund redrows on the assets. These generally balance on a monthly basis and only trigger drawdowns on the redraw facility at the end of period. In these situations the ADI will advance the redrows during the month. Interest free loans are therefore being made by the ADI to the SPV. APRA does not consider such informal arrangements to be eligible facilities. As a consequence these exposures would generally be deducted. If the ADI has such a facility in place, it would need to consider the requirements of APS 120 Attachment B paragraph 29 to ensure that appropriate capital is held against any undrawn commitments to its customers whose facilities have been transferred to the SPV.

Funding facilities

76. APS 120 requires that a funding facility provided by an originating ADI (other than a temporary funding facility provided during the establishment phase of a securitisation) does not fund a disproportionate amount of the pool of the SPV at any time during the life of the securitisation. Consistent with facilities being on an arm's-length basis and market terms and conditions, APRA expects that an originating ADI's assessment of 'disproportionate' would take into account factors such as:

- (a) the nature of the facility;

Spread accounts and similar surplus income arrangements

80. Attachment B to APS 120 sets out requirements for spread accounts and similar arrangements. In assessing whether an arrangement falls under this provision, APRA envisages that an ADI would look at the economic substance of the arrangement rather than the legal form.
81. Examples of other arrangements that might fall under these provisions could include residual capital units and subordinated bonus fees for servicing. The latter depends on the normal or base fee being set on a full market rate basis and the base or underlying agreement meeting all of the relevant requirements of APS 120 in its own right.

Liquidity facilities

82. There are two broad types of liquidity facilities used in the Australian market: those that provide short-term funding to cover timing mismatches between the receipt of payments from the underlying pool and the payments due to note holders; and those for asset-backed commercial paper (ABCP) programs. The latter are standby facilities that provide funding to the SPV should it be unable to refinance or roll-over maturing short term paper in the market. The former facility will generally be sized as a relatively small proportion of the pool, while the latter will often cover virtually the whole pool.
83. The provision in paragraph 2(f) of Attachment E to APS 120 would generally only be relevant to a liquidity facility that relates to the refinancing or rollover of securities issued by the SPV. This reflects the fact that in a liquidity facility that only covers timing mismatches, there are generally no securities that are being funded.

84. APRA does not intend paragraph 2(d) of Attachment E to APS 120 to prevent an ADI providing a timing mismatch liquidity facility to a non-ABCP securitisation in the ordinary course. This is provided that the draws are neither significant in size in relation to the pool nor structural (providing medium to long-term funding) in nature.
85. APRA considers structural borrowings to be in the nature of funding rather than liquidity facilities. In particular APRA believes it may be difficult, given their cash flow characteristics, to structure a liquidity facility to a reverse mortgage securitisation to meet the requirements for a facility under APS 120.
86. An unrated liquidity facility that does not qualify as an eligible liquidity facility will be subject to a capital deduction of the committed amount under the standardised approach, unless it is the most senior exposure in a securitisation or, for an ABCP securitisation, it is in a second loss or better position.
87. For an ADI with approval to use an internal ratings-based (IRB) approach to calculating regulatory capital for credit risk, an unrated liquidity facility that is not an eligible facility will be subject to capital deduction of the committed amount if none of the ratings-based approach, internal assessment approach nor supervisory formula can be applied.

Disclosure

88. APS 120 requires an originating ADI to ensure clear and prominent disclosures of certain matters in documents inviting investment in a securitisation. Best practice would be to include the disclosures as a stand-alone item on the inside front cover of the document as well as obtain, where this is possible given the trading environment, a signed acknowledgement from investors that they have read and understood the disclosures (which would be repeated in close proximity to the signature).

Cash collateral

89. Cash collateral provided to a back-up swap provider may not be assessed as an overlapping securitisation exposure to any swap provided to the securitisation vehicle. Where an ADI provides cash collateral to a back-up swap provider, it needs to assess the exposure against the requirements of APS120 Attachment E to calculate the appropriate risk weight.

Shared collateral and trust back arrangements

90. Trust back arrangements are a specific feature in some securitisation arrangements that enable an ADI to maintain a security interest for retained exposures where the underlying collateral/ security has been equitably assigned to the SPV (and is generally held by a security trustee).
91. In many instances, the arrangement operates such that the ADI does not share in the cash flows (including those arising from enforcement action) generated by the secured facilities provided to the customer on a pro-rata basis or better. In this case APRA would consider, for the purposes of Attachment C to APS 112, the ADI to be a second mortgagee. An ADI subject to APS 112 is, therefore, only eligible to assign a risk-weight of less than 100 per cent to its retained exposures if they meet the requirements of paragraph 13 of Attachment C to APS 112.



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