

Guidance Note

AGN 112.1 - Risk-Weighted On-Balance Sheet Credit Exposures

1. This Guidance Note and its Attachments set out how to calculate the risk-weighted amount of an ADI's on-balance sheet credit exposures for capital adequacy purposes.

[Index](#)

Scope

2. The risk-weighting process used for measuring an ADI's on-balance sheet credit exposures covers *all* on-balance sheet assets held by the ADI, except the following items which are specifically excluded:
 - (a) those assets or investments which are required to be deducted from Tier 1 or total capital as per [APS 111 – Capital Adequacy: Measurement of Capital](#);
 - (b) all debt and equity securities held in the trading book (the associated risk-weighted exposures are determined in accordance with [APS 113 – Capital Adequacy: Market Risk](#));
 - (c) all on-balance sheet positions in commodities (the associated risk-weighted exposures are determined in accordance with [APS 113 – Capital Adequacy: Market Risk](#)); and
 - (d) on-balance sheet unrealised gains on market-related off-balance sheet transactions (which are to be included in the calculation of an ADI's total risk-weighted off-balance sheet credit exposures – see [AGN 112.2](#)).

[Index](#)

Risk-Weighted Assets

3. An ADI's total risk-weighted on-balance sheet credit exposures equal the sum of the risk-weighted amount of each on-balance sheet asset it holds.
4. The risk-weighted amount of an on-balance sheet item is determined by multiplying its current book value (i.e. current outstanding amount including accrued interest or revaluations, and net of any specific provision or associated depreciation) by the relevant risk weight specified in [Attachment A](#).
5. Where an on-balance sheet claim on a counterparty is secured against eligible collateral and/or guarantee recognised by APRA, the secured portion of the claim (refer [paragraph 14](#)) should be weighted according to the risk weight appropriate to the collateral and/or the guarantor. The unsecured portion of the claim must be weighted according to the risk weight applicable to the original counterparty.
6. An ADI should consult APRA in case of doubt about how to determine the risk-weighted amount of a particular on-balance sheet transaction.
7. A worked example of the calculation of an ADI's capital ratio, including derivation of total risk-weighted amount of on-balance sheet assets (Step 2), is set out in [AGN 112.5](#).

[Index](#)

Eligible Collateral and Guarantees

8. The only forms of collateral which APRA recognises for capital adequacy purposes are:
 - (a) cash deposits (including any rights of set-off on credit balances) subject to the conditions set out in [Attachment B](#);
 - (b) securities issued by the Commonwealth, State and Territory Governments (including State and Territory central borrowing authorities) in Australia; central and state governments in OECD countries; OECD central banks; international banking agencies and multilateral regional development banks; and

- (c) residential mortgages subject to the criteria detailed in [Attachment C](#).
- 9. The underlying collateral arrangements must provide for direct, explicit, irrevocable and unequivocal recourse to the collateral.
- 10. Claims secured or collateralised in other ways, for example, by insurance contracts, put options, forward sales contracts or agreements, bank paper, securities issued by public sector entities etc, are not considered to be covered by eligible collateral. Such claims must be weighted according to the risk weight applicable to the original counterparty.
- 11. The only guarantees which APRA recognises for capital adequacy purposes are:
 - (a) guarantees provided by the Commonwealth, State, Territory and Local Governments (including State and Territory central borrowing authorities) in Australia; central, state and local governments in OECD countries; public sector entities in Australia and OECD countries; OECD central banks and other OECD banks; ADIs in Australia; international banking agencies and multilateral regional development banks. Guarantees provided by non-OECD central governments and central banks, as well as non-OECD banks are recognised, to a limited extent, subject to the relevant conditions set out in [Attachment A](#); and
 - (b) credit derivatives used for buying credit protection (refer [AGN 112.4](#)).
- 12. The guarantee must be issued formally and the underlying guarantee arrangements must provide for direct, explicit, irrevocable and unequivocal recourse to the guarantor.
- 13. Claims secured against indirect guarantees (e.g. guarantee of guarantee such as the Commonwealth's guarantee of the entity which provides the guarantee) and letters of comfort do not qualify as eligible guarantees. Such claims must be weighted according to the risk weight applicable to the original counterparty.
- 14. Coverage of collateral or guarantees is generally determined by the market value of the collateral or the amount of the guarantee in relation to the amount of the actual exposure supported by the collateral or guarantee.

15. Only collateral and/or guarantees actually posted may be used for determining risk weights. A commitment to provide collateral is not recognised as eligible collateral for risk weighting purposes.

[Index](#)

Attachment A

Risk Weights for On-Balance Sheet Assets

| | Risk Weight |
|--|--------------------|
| Category I – Cash Items | |
| 1. Notes and coins. | 0% |
| 2. Balances with and all other claims on the Reserve Bank of Australia. | 0% |
| 3. Claims to the extent that they are secured against eligible cash collateral (refer Attachment B). | 0% |
| 4. Gold bullion held in own vaults or, on an allocated basis by another party to the extent that it is backed by gold bullion liabilities. | 0% |
| Gold held on an unallocated basis by another party, though backed by gold liabilities, is weighted as a claim on the counterparty unless a lower risk weight is approved by APRA. | |
| 5. Gold held as collateral to the extent that the underlying claim being collateralised is denominated in gold. | 0% |
| 6. Cash items in the process of collection (e.g. cheques, drafts and other items drawn on other ADIs or overseas banks that are payable immediately upon presentation and that are in the process of collection). | 20% |
| Category II – Claims on Australian & Foreign Governments | |
| 7. All claims held in the banking book ¹ on, or claims to the extent that they are guaranteed by or secured against securities issued by, the Commonwealth, State or Territory Governments in Australia (including State or Territory central borrowing authorities). | 0% |

¹ All claims on these entities which are held in the trading book are treated in accordance with [APS 113 – Capital Adequacy: Market Risk](#).

Risk Weights for On-Balance Sheet Assets (cont'd)

| | Risk Weight |
|---|--------------------|
| 8. Claims on, or claims to the extent that they are guaranteed by, local governments in Australia. | 20% |
| 9. All claims held in the banking book ² on, or claims to the extent that they are guaranteed by or secured against securities issued by, central and state governments in OECD countries ³ . | 0% |
| 10. Claims on, or claims to the extent that they are guaranteed by, local governments in OECD countries ⁴ . | 20% |
| 11. All claims held in the banking book ⁵ on, or claims to the extent that they are guaranteed by, central governments in non-OECD countries, which are denominated and funded in local currency of the country concerned. | 0% |
| 12. All claims held in the banking book ⁶ on, or claims to the extent that they are guaranteed by, governments in non-OECD countries other than those denominated and funded in local currency of the country concerned. | 100% |

Category III – Claims on Public Sector Entities & Public Trading Enterprises

| | |
|---|-----|
| 13. Claims on, or claims to the extent that they are guaranteed by, public sector entities (except those which have corporate status and operate on a commercial basis) in Australia. | 20% |
|---|-----|

² Refer [footnote 1](#).

³ These include countries which have concluded special lending arrangements under the IMF's General Arrangements to Borrow (Saudi Arabia at this stage), provided that they have not rescheduled their external debt, whether to official or private sector creditors, within the previous five years.

⁴ Refer [footnote 3](#).

⁵ Refer [footnote 1](#).

⁶ Refer [footnote 1](#).

Risk Weights for On-Balance Sheet Assets (cont'd)

| | Risk Weight |
|---|--------------------|
| 14. Claims on public trading enterprises in Australia which have corporate status and operate on a commercial basis (notably in significant competition with private sector enterprises). | 100% |
| 15. Claims on, or claims to the extent that they are guaranteed by, non-commercial public sector entities in OECD countries ⁷ . | 20% |
| 16. Claims on commercial companies owned by public sector entities in OECD countries ⁸ . | 100% |

Category IV – Claims on Central Banks, International Banking Agencies, Regional Development Banks, ADIs in Australia and Overseas Banks⁹

| | |
|--|------|
| 17. All claims held in the banking book ¹⁰ on, or claims to the extent that they are guaranteed by or secured against securities issued by, central banks in OECD countries ¹¹ . | 0% |
| 18. All claims held in the banking book ¹² on, or claims to the extent that they are guaranteed by, central banks in non-OECD countries, which are denominated and funded in local currency of the country concerned. | 0% |
| 19. All claims held in the banking book ¹³ on, or claims to the extent that they are guaranteed by, central banks in non-OECD countries other than those denominated and funded in local currency of the country concerned. | 100% |

⁷ Refer [footnote 3](#).

⁸ Refer [footnote 3](#).

⁹ All references to “overseas banks” under Category IV include financial institutions in a country which (i) have the power to accept deposits in the regular course of business; (ii) are supervised by the supervisor of banks; and (iii) are subject to the same prudential requirements as banks (including capital adequacy).

¹⁰ Refer [footnote 1](#).

¹¹ Refer [footnote 3](#).

¹² Refer [footnote 1](#).

¹³ Refer [footnote 1](#).

Risk Weights for On-Balance Sheet Assets (cont'd)

| | Risk Weight |
|---|--------------------|
| 20. Claims (excluding subordinated debt instruments) on, or claims to the extent that they are guaranteed by or secured against securities issued by, international banking agencies and multilateral regional development banks. | 20% |
| <p>These include the IMF, the International Bank for Reconstruction and Development, the Bank for International Settlements and the Asian Development Bank.</p> | |
| 21. Holdings of subordinated bonds issued by international banking agencies and multilateral regional development banks. | 100% |
| <p>These include the IMF, the International Bank for Reconstruction and Development, the Bank for International Settlements and the Asian Development Bank.</p> | |
| 22. All claims (other than equity and debt capital investments) held in the banking book ¹⁴ on, or claims to the extent that they are guaranteed by, ADIs (including Australian branches of foreign ADIs and overseas branches of locally incorporated ADIs) in Australia. | 20% |
| 23. All claims (other than equity and debt capital investments) held in the banking book ¹⁵ on, or claims to the extent that they are guaranteed by, overseas banks incorporated in OECD countries ¹⁶ . | 20% |
| <p>This includes claims on, or guaranteed by, their branches in all countries.</p> | |

¹⁴ All claims on ADIs and overseas banks (including equity and debt capital instruments) which are held in the trading book are treated in accordance with [APS 113 – Capital Adequacy: Market Risk](#). Equity and debt capital investments in other ADIs and overseas banks (including their subsidiaries) which are not consolidated for capital adequacy purposes are deducted from an ADI's total capital (see [APS 111 – Capital Adequacy: Measurement of Capital](#)).

¹⁵ Refer [footnote 14](#).

¹⁶ Refer [footnote 3](#).

Risk Weights for On-Balance Sheet Assets (cont'd)

| | Risk Weight |
|---|--------------------|
| <p>24. All claims (other than equity and debt capital investments) held in the banking book¹⁷ on, or claims to the extent that they are guaranteed by, designated banks incorporated in non-OECD countries of the Asia-Pacific region as agreed by APRA¹⁸.</p> <p>This includes claims on, or guaranteed by, their branches in all countries.</p> | 20% |
| <p>25. All claims (other than equity and debt capital investments) held in the banking book¹⁹ on, or claims to the extent that they are guaranteed by, overseas banks incorporated in non-OECD countries (other than a bank referred to in item 24), with a residual maturity of one year or less.</p> <p>This includes claims on, or guaranteed by, their branches in all countries.</p> | 20% |
| <p>26. All claims (other than equity and debt capital investments) held in the banking book²⁰ on overseas banks incorporated in non-OECD countries (other than a bank referred to in item 24), with a residual maturity exceeding one year. This includes claims on their branches in all countries.</p> <p>Claims guaranteed by these non-OECD banks (and their branches in all countries) with a residual maturity exceeding one year are weighted according to the risk weight applicable to the original counterparty.</p> | 100% |

¹⁷ Refer [footnote 14](#).

¹⁸ A bank incorporated in the Asia-Pacific region wishing to be afforded this treatment must apply to APRA. APRA is willing to consider, on a case-by-case basis, assigning claims on, or guaranteed by, non-OECD banks from the Asia-Pacific area the same risk weight as claims on, or guaranteed by, OECD banks provided the bank is of high international standing and the parent country has a supervisory framework and standards equivalent to that applied in Australia.

¹⁹ Refer [footnote 14](#).

²⁰ Refer [footnote 14](#).

Category V – Claims Secured Against Residential Mortgages

- | | |
|--|-----|
| 27. Loans and all other claims secured against eligible residential mortgages (refer Attachment C). | 50% |
|--|-----|

Category VI – Other Assets & Claims

- | | |
|---|------|
| 28. Stockbroking positions awaiting settlement. | 50% |
| 29. All claims on private sector counterparties (other than ADIs or overseas banks ²¹). | 100% |
| This includes e.g. personal and corporate loans; commercial and industrial loans; leasing finance and bill acceptances drawn by private sector counterparties; all other property loans (including loans secured against commercial property); holdings of corporate debt securities and shares in the banking book ²² ; and claims on other financial institutions. | |
| 30. Investments in premises, plant and equipment and all other fixed assets. | 100% |
| 31. Claims on all fixed assets under operating leases. | 100% |
| 32. All other assets and claims not elsewhere specified. | 100% |

[Index](#)

²¹ Overseas banks as defined in [footnote 9](#).

²² Corporate debt securities and shares held in the trading book are treated in accordance with [APS 113 – Capital Adequacy: Market Risk](#).

Attachment B

Eligible Cash Collateral

Credit exposures (on- or off-balance sheet) which are collateralised by cash deposits (including any set-off arrangements) can be weighted as equivalent to a claim on cash, subject to satisfying the following criteria:

1. There must be a formal written contractual agreement between the lender (or party holding a claim) and the party lodging the cash collateral which establishes the lender's direct and unconditional recourse to the cash collateral. A common law right of set-off is insufficient on its own to satisfy this condition.
2. Where cash collateral is lodged by a third party, that other party must also indemnify or guarantee the borrower's obligations (or those of the party on which a claim is held) to the lender. The lender must ensure that the arrangement will not fail for lack of consideration.
3. In the event of default, any requirement on the lender to serve notice on the party lodging the collateral must not impede the lender's recourse to the collateral.
4. The cash collateral must not be lodged with an entity other than the lender, except where:
 - (a) the lender and the entity holding the collateral belong to the same consolidated group of an ADI; and
 - (b) the entity holding the collateral is bound to act in accordance with the agreement between the lender and the party lodging the collateral.
5. Subject to [paragraph 4](#), where cash collateral is lodged with an overseas entity, the lender must ensure that legal agreements entered into are binding in the jurisdiction in which the cash is held.
6. Where cash collateral is lodged with the lender's overseas branches, the branches holding the collateral must be bound to act in accordance with the agreement between the lender and the party lodging the collateral. The lender must also ensure that legal agreements entered into are binding in the jurisdiction in which the cash is held.

7. Where cash collateral lodged is denominated in a currency different from the underlying exposure being collateralised, it must be valued at current market exchange rates.
8. Where cash collateral lodged is in the form of certificate of deposits or like instruments issued by the lender or any eligible entity described in [paragraph 4](#), the lender must retain physical possession of the instrument until the collateral obligations are extinguished.
9. Where the party lodging the cash retains access to the collateral, the lender must retain the right to block access to the cash collateral at any time.

[Index](#)

Attachment C

Eligible Residential Mortgages

For capital adequacy purposes, a loan for housing or other purposes to an individual borrower which is fully secured by registered mortgage over a residential property (whether or not the property is owned by the borrower) is assigned a concessional risk weight of 50 per cent subject to satisfying the criteria set out below.

The concessional risk weight does not apply to mortgage-backed securities, which are risk-weighted as a claim on the actual issuer (and not the sponsor) of the securities. Other asset-backed paper should be risk-weighted in a similar fashion.

Lending Criteria

1. An ADI must at all times have a clear and unequivocal access to the mortgaged residential property in the event of default by the borrower.
2. An ADI must have procedures in place to assess the ability of borrowers to meet repayment obligations. The assessment criteria must be documented as part of the ADI's Lending / Credit Policy and Procedures Manual.
3. An ADI must have in place verification procedures to substantiate critical application data provided by the borrower. Such procedures must be documented in the ADI's Lending / Credit Policy and Procedures Manual. Essentially, these should include procedures for verifying income documentation sufficient for the ADI to make an assessment of the repayment capacity of the borrower. All material income sources and employment details of the borrower must be assessed by the ADI prior to loan approval, and documented as part of the loan origination and approval process.
4. An ADI may apply a concessional risk weight of 50 per cent to a loan fully secured by a residential property which was originally subject to a 100 per cent risk weight because of failure to satisfy the requirements set out in paragraphs 2 and 3 above, provided the borrower has substantially met contractual loan repayments continuously over the last 36 months. Criteria defining when contractual loan repayments are substantially met must be set out in the ADI's Lending / Credit Policy and Procedures Manual.

5. Where an ADI outsources any part of its credit assessment process to a third party (such as mortgage originators and brokers), the arrangement must comply with APS 231 – Outsourcing¹. The ADI should undertake due diligence on all third parties it uses to make any lending decisions or that undertake assessments of borrower information on its behalf. There should be a formal agreement in place with the third party that specifies the criteria that are to be used in approving the loan. The ADI must have audit and monitoring procedures in place to ensure that its lending criteria are applied at all times by the third party credit assessor.
6. Where an ADI accepts the purchase price, or other means of valuation, as being an indication of the value of the residential property offered as security for a loan (in lieu of a formal valuation), the ADI must detail the criteria used to justify this use in its Lending / Credit Policy and Procedures Manual. The Manual must include clear guidelines which detail the circumstances under which the purchase price or other means of valuation are acceptable to the ADI as an indication of the property value as well as circumstances where a formal valuation of the property is required (see [paragraph 7](#) below).
7. Where an ADI requires a formal valuation of each residential property offered as security for a loan, the valuation must be carried out by an independent accredited valuer nominated by the ADI. The ADI's Lending / Credit Policy and Procedures Manual should document procedures for determining whether a formal valuation of one or more existing residential property security is required when the specific property or properties are to be used in support of a new loan. The ADI's Lending / Credit Policy and Procedures Manual should also document the procedures to be followed for revaluing properties where the ADI becomes aware of a material change in the value of properties in an area or region.
8. Any residential property offered as security for a loan must be readily marketable. In assessing the marketability of such property, an ADI may take into account factors such as whether the property is within residential or rural residential zoning, or other evidence which can demonstrate that the property is likely to be readily sold (such as recent price and turnover data for similar properties in the same area or region). This would normally exclude remote rural residential properties or residential properties that could only be sold at a significant discount. An ADI must detail its policy for determining the marketability of a residential property offered as security in its Lending / Credit Policy and Procedures Manual.

¹ Where an ADI uses a third party for loan administration functions only, and does not outsource any part of the credit assessment process to the third party, the responsibility for ensuring that the lending criteria are met remains with the ADI.

9. Where security is provided by third parties (i.e. parties other than the specific borrower), an ADI should ensure that those parties understand fully the consequences of default on the loans and their legal obligations. Loans covered by security provided by third parties, where the relevant mortgage is unenforceable under the Consumer Credit Code, are risk-weighted at 100 per cent in the absence of any eligible collateral and guarantees.
10. Subject to satisfying other criteria set out in this Attachment, loans for purposes other than housing must be fully secured against mortgages over *existing* residential property to receive a 50 per cent risk weight. Loans, for whatever purpose, secured against speculative residential construction or property development – e.g. multiple dwellings such as blocks of units – do not qualify for a concessional risk weight.

Loan to Valuation Ratio

11. To qualify for the concessional risk-weight, the ratio of the outstanding amount of the loan to the value of the mortgaged residential property securing the loan must not exceed 80 per cent unless the loan is 100 per cent mortgage insured through an acceptable lenders mortgage insurer (LMI)². Any loans that are fully secured by residential properties but fail to meet any of the criteria set out in paragraphs 2, 3, 6, 7 and 8 above must be risk-weighted at 100 per cent in the absence of any eligible collateral and guarantees, unless the ratio of the outstanding amount of the loan to the value of the mortgaged residential property securing the loan is 60 per cent or less, or the loan is fully mortgage insured with an acceptable LMI, in which case the loan is to be risk-weighted at 50 per cent.
12. The “outstanding amount” of the loan is calculated as the balance of all claims on the borrower that are secured against the mortgaged residential property. This includes accrued interest and fees, as well as the gross value of any undrawn limits on commitments (which cannot be cancelled at any time without notice) e.g. any redraw amount available on the loan or undrawn limit on a revolving credit facility. The outstanding amount under an “all moneys” mortgage should include all loans and other exposures to the borrower that are effectively secured against the mortgage.
13. Where the loan is also secured against a second mortgage, the outstanding amount of the loan is calculated as the sum of all claims on the borrower

² All loans approved by banks prior to 5 September 1994 to an individual which are fully secured by residential properties are not subject to the 80 per cent loan-to-valuation ratio requirement and will continue to attract a concessional risk weight of 50 per cent for capital adequacy purposes.

secured by both the first and second mortgages over the same residential property for the purpose of assessing the loan to valuation ratio.

14. Where the loan is secured by more than one property, the loan to valuation ratio is determined on the basis of the outstanding amount of the loan to the aggregate value of the mortgaged residential properties.
15. In calculating the outstanding amount of the loan, allowance can be made for eligible collateral (other than eligible residential mortgages) and guarantees. The portion of any balances covered by such arrangements is deducted from the outstanding amount of the loan and weighted according to the risk weight applicable to the collateral or guarantor (refer [Attachment A](#)). A mortgage offset or similar account may only be netted off against the outstanding amount of the loan where the arrangement meets the requirements for eligible cash collateral as set out in [Attachment B](#).

Mortgage Insurance

16. “100 per cent mortgage insurance” as described in [paragraph 11](#) above includes cover for realised losses with respect to the full value of an outstanding loan balance.
17. To qualify as mortgage insured by an acceptable LMI, the policy covering the loan must be taken out with an LMI that has a rating the equivalent of “A” or higher by a credit ratings agency set out in [AGN 113.3 – The Standard Method](#) (Table 1), and is subject to supervision by an approved insurance regulator.
18. An associated (e.g. captive) LMI, though unrated, may qualify as an acceptable LMI where it is able to demonstrate a claim paying ability rated “A” or higher, for example, through third party guarantee and reinsurance arrangements. APRA will consider non-rated associated LMIs on a case-by-case basis.
19. APRA is willing to consider other forms of mortgage insurance arrangements as satisfying this requirement where an ADI can demonstrate that the insurance arrangements leave it in the same risk position, where:
 - (a) in the case that the loan fails to satisfy any of the criteria set out in paragraphs [2](#), [3](#), [6](#), [7](#) and [8](#) above – as if the loan in question had a ratio of the outstanding amount to the value of the mortgaged residential property of 60 per cent or less;

- (b) in other cases – as if the loan in question had a ratio of the outstanding amount to the value of the mortgaged residential property of 80 per cent or less.

Second Mortgages

- 20. To qualify for a 50 per cent risk weight, any loans secured by a second mortgage over residential property must, in addition to the requirements of loan to valuation ratio set out above, satisfy the following conditions:
 - (a) the first mortgage must not be able to be extended without being subordinated to the second mortgage;
 - (b) an ADI must obtain a written consent of the first mortgagee for the second mortgage and confirm the maximum outstanding amount of the loan secured by the first mortgage (including maximum drawdown or limit of facility) for loan to valuation ratio purposes; and
 - (c) an ADI must ensure that its interest as second mortgagee is noted on the title.

[Index](#)