



Discussion Paper

Covered bonds and securitisation matters


8 November 2011

Disclaimer and copyright

While APRA endeavours to ensure the quality of this publication, it does not accept any responsibility for the accuracy, completeness or currency of the material included in this publication and will not be liable for any loss or damage arising out of any use of, or reliance on, this publication.

© Australian Prudential Regulation Authority (APRA)

This work is licensed under the Creative Commons Attribution 3.0 Australia Licence (CCBY 3.0).

 This licence allows you to copy, distribute and adapt this work, provided you attribute the work and do not suggest that APRA endorses you or your work. To view a full copy of the terms of this licence, visit www.creativecommons.org/licenses/by/3.0/au/.

Preamble

This discussion paper outlines proposed changes to APRA's prudential standards following commencement of the *Banking Amendment (Covered Bonds) Act 2011* (Covered Bonds Act). The Covered Bonds Act amended the *Banking Act 1959* (Banking Act) to allow authorised deposit-taking institutions (ADIs) to issue covered bonds.

Following commencement of the Covered Bonds Act, APRA has amended *Prudential Standard APS 120 Securitisation* (APS 120) to remove the prohibition on ADIs issuing covered bonds. This discussion paper sets out APRA's proposals to introduce a new prudential standard and make amendments to existing prudential standards in relation to requirements for authorised deposit-taking institutions (ADIs) that issue covered bonds. The draft of the new *Prudential Standard APS 121 Covered Bonds* (APS 121) is available on the APRA web site (www.apra.gov.au).

APRA invites written submissions on the proposals contained in this discussion paper. Following consideration of submissions received, APRA will finalise its proposed new and amended prudential standards with a view to implementation in early 2012.

This discussion paper also canvasses changes to APS 120 to clarify the prudential treatment of holdings of subordinate tranches of securitisations held by an ADI other than the originator of the loans. Subject to feedback from the consultation on this proposal, APRA envisages that the proposed change would be incorporated into APS 120 and take effect from 1 January 2012.

Further details of the legislative framework for covered bonds are contained in the Banking Act and the Explanatory Memorandum that accompanied the Banking Amendment (Covered Bonds) Bill 2011 and these documents should be read alongside this Discussion paper. Both the Act and the Explanatory memorandum are available via www.comlaw.gov.au.

This discussion paper is available on APRA's website at www.apra.gov.au. Written submissions on the paper should be forwarded by 9 December 2011, by email to: coveredbonds@apra.gov.au and addressed to:

Helen Rowell
General Manager, Policy Development
Policy, Research and Statistics
Australian Prudential Regulation Authority
GPO Box 9836
Sydney NSW 2001

Important

Submissions will be treated as public unless clearly marked as confidential and the confidential information contained in the submission is identified.

Submissions may be the subject of a request for access made under the Freedom of Information Act 1982 (FOIA). APRA will determine such requests, if any, in accordance with the provisions of the FOIA.

Information in submissions about a regulated entity that is not in the public domain will be protected by section 56 of the Australian Prudential Regulation Authority Act 1998 and therefore will ordinarily be exempt from production under the FOIA.

Contents

Glossary	5
Chapter 1 – Introduction	6
Overview	6
Chapter 2 – Prudential requirements for covered bonds	7
Relationship to securitisation	7
Application	7
Key principles	7
Assets in Australia	7
Covered bond SPV	8
Assets in the cover pool	8
Assets outside the cover pool	9
Liabilities of the covered bond SPV	10
Cross-default provisions	10
Collateral requirements for other obligations	10
Miscellaneous matters related to the issuing of covered bonds	11
Holdings of covered bonds by ADIs	11
Chapter 3 – Holdings of subordinated tranches of non-originated securitisations	12
Chapter 4 – Request for cost-benefit analysis information	13
Appendix 1	14

Glossary

ADI	Authorised deposit-taking institution
APRA	Australian Prudential Regulation Authority
APS 110	<i>Prudential Standard APS 110 Capital Adequacy</i>
APS 111	<i>Prudential Standard APS 111 Capital Adequacy: Measurement of Capital</i>
APS 112	<i>Prudential Standard APS 112 Capital Adequacy: Standardised Approach to Credit Risk (APS 112)</i>
APS 113	<i>Prudential Standard APS 113 Capital Adequacy: Internal Ratings-based Approach to Credit Risk (APS 113)</i>
APS 120	<i>Prudential Standard APS 120 Securitisation</i>
APS 121	<i>Prudential Standard APS 120 Covered Bonds</i>
Banking Act	<i>Banking Act 1959</i>
Covered Bonds Act	<i>Banking Amendment (Covered Bonds) Act 2011</i>
IRB	Internal ratings-based approach to credit risk
SPV	Special purpose vehicle

Chapter 1 – Introduction

Overview

In December 2010, the Treasurer announced that the Government would amend the *Banking Act 1959* (Banking Act) to allow authorised deposit-taking institutions (ADIs) to issue covered bonds. This amendment took effect on 17 October 2011 when the *Banking Amendment (Covered Bonds) Act 2011* (Covered Bonds Act) received Royal Assent. Further information on the Covered Bonds Act is contained in the Explanatory Memorandum that accompanied the *Banking Amendment (Covered Bonds) Bill 2011*.¹

This discussion paper sets out APRA's proposed requirements for ADIs that issue covered bonds. The Covered Bonds Act amended the operation of the existing preference provisions contained in subsection 13A(3) of the Banking Act and inserted a new Division 3A of Part II. Accordingly, APRA has removed the prohibition on ADIs issuing covered bonds contained in paragraph 7 of the current *Prudential Standard APS 120 Securitisation (APS 120)*.²

APRA proposes to issue a new prudential standard, *Prudential Standard APS 121 Covered Bonds (APS 121)*, dealing with covered bonds. The objective of this prudential standard is to ensure that ADIs that issue covered bonds appropriately manage the associated risks, including those to which they may become exposed via the covered bond special purpose vehicle (SPV). APRA proposes to require ADIs to identify the assets transferred to a covered bond SPV and whether those assets form part of the cover pool held as collateral against covered bonds or are held by the covered bond SPV for other purposes associated with the issue of covered bonds.

The draft APS 121 also sets out the proposed treatment for capital adequacy purposes of credit exposures involved with the issue of covered bonds and the risks to the ADI associated with the holding of assets by the covered bond SPV. Finally, draft APS 121 deals with various consequential matters associated with the issue of covered bonds, as set out in Chapter 2 of this discussion paper.

Consequential amendments to several other ADI prudential standards are also proposed to support the proposals in APS 121. These amendments are set out in Appendix 1.

APRA will consider submissions received on this discussion paper, draft APS 121 and the proposed amendments to other ADI prudential standards. APRA proposes to finalise APS 121 and the other prudential standards with a view to their implementation in early 2012.

APRA will also develop reporting standards and forms relating to the issuing of covered bonds and ADIs' exposures to covered bond SPVs. APRA intends to release these for consultation by early 2012.

ADIs that issue covered bonds prior to the commencement of APS 121 and the consequential amendments to other prudential standards are encouraged to take note of the proposals in this discussion paper.

Chapter 3 of this discussion paper addresses a proposal relating to the capital treatment of subordinated tranches of securitisations issued by another entity. This is a separate matter, unrelated to covered bonds, but has been included in this discussion paper for convenience.

¹ The Explanatory Memorandum is available at: www.comlaw.gov.au/Details/C2011B00187/Explanatory%20Memorandum/Text.

² APRA's letter to ADIs of 20 October 2011 advising of this change is available at: www.apra.gov.au/adi/Publications/Pages/other-information-for-adis.aspx

Chapter 2 – Prudential requirements for covered bonds

Relationship to securitisation

A covered bond is not a securitisation for the purposes of APS 120 and a securitisation is not a covered bond (as defined in the Banking Act).

A securitisation must comply with the requirements of APS 120. The recourse of securitisation funding providers is intended to be exclusively to the securitised assets and there is no intention that these providers have recourse to the ADI, even in limited or unlikely circumstances.

In contrast to a securitisation, a covered bond provides a funding provider with an intended dual recourse to both the issuer and a cover pool of assets. Covered bonds issued by an ADI that involve use of assets of the ADI in Australia will need to comply with Division 3A of Part II of the Banking Act and with the proposed APS 121.

Application

APRA proposes to align those provisions in ADI prudential standards that relate to covered bonds with the scope of Division 3A of Part II of the Banking Act. That Division does not apply to foreign ADIs or covered bonds secured wholly by assets outside Australia. APRA may, at a later date, consider whether prudential standards should also apply to covered bonds issued by Australian branches of foreign ADIs or covered bonds issued by Australian ADIs that are wholly secured by assets outside Australia.

Key principles

The board and senior management of an ADI are responsible for establishing and implementing policies and procedures for the issue of covered bonds and ensuring that those policies are followed. The board and senior management will be expected to demonstrate due diligence in assessing the risks and considering the consequences, under stress scenarios, of issuing covered bonds.

The rights and interests of covered bond holders and the obligations and rights of the issuing ADI must be clearly and fully set out in contractual documentation. This includes the circumstances where covered bond holders may activate the covered bond guarantee to access the collateral in the cover pool (and only the cover pool) and the standing of the covered bond SPV following a default by the ADI.

The specific form and contents of documentation relating to covered bonds is a matter of negotiation between ADIs as issuers, the trustees of covered bond SPVs and covered bond holders.

Assets in Australia

APRA proposes that, when assessing compliance with the limit on covered bond issuance in section 28 (and section 31D) of the Banking Act, the appropriate measure of assets in Australia is total assets as required to be reported on *ARF 320.0 Statement of Financial Position (Domestic Books)* (ARF 320.0).

APRA notes that this would mean that the definition of assets in Australia for the purpose of issuing covered bonds is different from that contained in section 13A(4) of the Banking Act, which requires that assets in Australia are greater than an ADI's deposit liabilities in Australia. APRA acknowledges the desirability of having a closer alignment between these definitions and will consider the definition of assets in Australia for the purpose of APS 121 further in due course.

APRA is aware that credit unions and building societies are not currently required to complete ARF 320.0. APRA proposes to amend *ARS 320.0 Statement of Financial Position (Domestic Books)* (ARS 320.0) to require credit unions and building societies that issue covered bonds to complete ARF 320.0.

Covered bond SPV

Section 26(2) of the Banking Act provides that the purposes of the covered bond SPV must relate only to the covered bonds. APRA expects that ADIs will ensure that any covered bond SPV that it uses to hold collateral for covered bonds only has purposes consistent with this requirement.

To ensure transparency and certainty as to the obligations between the ADI and the covered bond SPV, the terms of all agreements, rights and obligations between the ADI and the covered bond SPV must be formally and legally documented, as set out in draft APS 121. The intention is to ensure that ADIs, covered bond holders and APRA have a clear understanding of the legal rights and obligations of all parties involved in a covered bond issue.

An ADI remains exposed to the risks associated with assets that are transferred to a covered bond SPV. Consequently, these assets must continue to be managed prudently and appropriately, and taken into account as part of the ADI's overall risk management strategy. APRA expects that, in the vast majority of cases, the issuing ADI will remain responsible for administering loans that are equitably assigned to the covered bond SPV. As such, consistent with the expectations of covered bond holders, the ADI should, to the maximum extent practicable, continue to administer the assets of the covered bond SPV consistent with the ADI's policy for similar assets that remain on its books.

It is critical that an ADI can identify all relevant claims on assets held by the covered bond SPV so that it can verify compliance with the Banking Act and APRA's prudential standards, including capital requirements. Accordingly, APRA proposes to require that issuing ADIs maintain certain registers for prudential purposes and APRA may assess compliance with this requirement from time to time. Such registers will provide covered bond holders, the ADI involved and APRA with a continuing clear record of those assets that have been provided as collateral to covered bond holders and other parties, and hence may no longer be available to protect the Australian depositors of the ADI. The registers are also intended to remove

any confusion about assets of the covered bond SPV that are not available to covered bond holders and that can be freely returned to the ADI at any time, including after covered bond holders have activated the guarantee. Issuing ADIs will also be expected to be able to identify all derivatives and other transactions outstanding with a covered bond SPV.

The cover pool can contain over-collateralisation (whether legislative, contractual or voluntary) and all assets that secure liabilities to covered bond holders in priority to any other liability must be treated as part of the cover pool. In considering whether an asset meets this test, it is appropriate to consider not only a going concern scenario but also whether triggers in any of the covered bond documentation, or other events, could result in covered bond holders having a claim that ranks ahead of any other liability.

APRA expects that, as part of an ADI's administration of assets held by a covered bond SPV, the relevant assets are subject to the ADI's normal practices for impairment testing, provisioning and, where relevant, marking to market. Regardless, should the assets ever be transferred from the covered bond SPV back to the ADI, the ADI will be required to ensure that the transferred assets are subject to impairment testing or marking to market, as appropriate, at that time.

Assets in the cover pool

Section 28 of the Banking Act provides that an ADI may not issue covered bonds if the combined value of Australian assets in cover pools securing those covered bonds would exceed eight per cent of the value of an ADI's assets in Australia, or such other percentage as is prescribed in regulation. This test will be applied at the time of issuance. Reflecting the seriousness with which APRA will view any breach of this legislative limit, an appropriate responsible person of the ADI will be required to certify that the ADI complied with this requirement at the time of issue of the covered bond.

The Banking Act does not prevent assets held in cover pools from exceeding the eight per cent limit. APRA proposes, however, to treat assets above the limit differently for prudential purposes than assets below the limit.

Section 31D of the Banking Act provides that below the eight per cent limit, assets are to be treated as assets of the ADI. Accordingly, up to that limit (or such other amount as may be prescribed in regulation), assets in the cover pool will be treated under APRA's prudential standards as assets of the ADI. This means that they are to be treated as if they were still held by the ADI for purposes of applying APRA's capital requirements for credit risk, large exposures and related party exposures.

APRA will look through any interposed structures, such as the covered bond SPV, in relation to these assets. For example, where such assets would be held on the banking book if they were owned directly by the ADI, they should be risk-weighted according to *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.

If the value of assets in cover pools exceeds the eight per cent limit, APRA proposes that the excess will be deducted from Tier 1 capital (or Common Equity Tier 1 following the introduction of Basel III). This treatment reflects the fact that the claims of covered bond holders rank ahead of depositors in relation to these assets even though they exceed the legislative limit. This treatment is also consistent with the treatment of over-collateralisation in a securitisation. APRA also proposes to require an ADI to notify it in writing of the reasons for the excess and an indication of the timeframe in which assets in cover pools may fall back below the eight per cent limit.

Allocating high quality assets to a cover pool could lead to a deterioration in the average quality of assets remaining in the ADI. If this were to result in a situation where the overall level and/or concentration of risks remaining in the ADI were to become excessive relative to its capital, APRA may consider adjusting an ADI's prudential capital ratio to reflect the ADI's overall risk profile.

Assets outside the cover pool

APRA recognises that an ADI may wish to transfer other assets to a covered bond SPV, other than assets intended to become part of the cover pool at that time. Reasons for doing so could include to provide a management buffer or to collateralise a derivative contract using assets outside the cover pool. The prudential treatment of such assets will depend upon the degree of control that the ADI retains over them.

The general principle underlying APRA's proposed approach is that assets of the covered bond SPV (other than in the cover pool) are to be risk-weighted at the greater of 100 per cent or the relevant risk-weight detailed in Attachment A to APS 112. For an ADI using the internal-ratings based (IRB) approach, these assets are to be excluded from the application of APS 113 and risk-weighted according to APS 112.

An asset may be treated as if it were still held by the ADI without reference to the interposed structure if:

- it is separately identifiable;
- no part of the asset is included in the cover pool or secures covered bond liabilities; and
- the ADI has an unconditional authority to deal with the asset, including a right to require that it be transferred back to the ADI at any time.

In such a case, the asset may be treated for prudential purposes in the same manner as if it had been retained on the ADI's balance sheet. To qualify for this treatment, assets will also need to satisfy requirements relating to their administration and disclosure of the ADI's interest and rights in legal documentation involving the ADI, covered bond holders and the covered bond SPV and its trustee.

APRA proposes to have the discretion to require an ADI, at the ADI's expense, to seek an opinion from an appropriate independent expert on whether assets held by the covered bond SPV satisfy the requirements for a risk-weighting of less than 100 per cent.

Where an ADI retains an interest in collateral assigned to a covered bond SPV (such as trust-back assets), application of a risk-weighting of less than 100 per cent for these exposures will require that these exposures meet the same conditions as specified for a securitisation (see APS 120, Attachment B, paragraph 28). This includes the requirement for a formal second mortgage. These requirements are intended to apply to all ADIs, regardless of whether they use the standardised or IRB approach to calculate capital requirements for credit risk.

Liabilities of the covered bond SPV

Liabilities between the ADI and the covered bond SPV (for example, the loan from the ADI to the covered bond SPV and derivatives between the two parties) will be disregarded for the purposes of applying prudential standards. All other liabilities of the covered bond SPV are to be treated as liabilities of the ADI for prudential purposes.

One consequence of this approach is that the loan from the ADI to the covered bond SPV can be disregarded when determining large exposures and related entity exposures for the purposes of *Prudential Standard APS 221 Large Exposures (APS 221)* and *Prudential Standard APS 222 Associations with Related Entities (APS 222)*.

Cross-default provisions

APRA intends that cross-default clauses cannot be used to circumvent the eight per cent covered bond issuance limit by deeming a default on a covered bond if the issuing ADI defaults on some other instrument. Therefore, APRA proposes to prohibit ADIs from allowing covered bond holders to make a claim on the covered bond SPV or the cover pool unless the issuing ADI has defaulted on its obligations under a covered bond secured by the same cover pool.

Collateral requirements for other obligations

Some ADIs may have negative pledge or similar clauses in their existing contracts. APRA expects that ADIs will identify and assess any such obligations prior to issuing covered bonds. APRA proposes to require ADIs to determine whether such clauses could give rise to an obligation to accelerate payments under the existing obligation or to provide collateral against it as a result of providing collateral under covered bond issues. APRA proposes to require that ADIs also assess the implications that accelerating payments or providing collateral may have for the ADI's capital and liquidity, and for its borrowing capacity. ADIs would be expected to ensure that issuing covered bonds would not give rise to a situation where the ADI would breach any requirement of the Banking Act or APRA's prudential standards.

Miscellaneous matters related to the issuing of covered bonds

Consistent with the existing approach to prudential reporting, if APRA requires a report from the cover pool monitor, any costs of obtaining such a report are to be borne by the issuing ADI.

APRA intends that an issuing ADI will be required to supply APRA with copies of all relevant documentation relating to an issue of covered bonds upon request. Where this documentation is requested, it should not be inferred, however, that supplying this documentation to APRA implies APRA's consent to the transaction or confirmation from APRA that the transactions comply with either the Banking Act or APRA's prudential standards.

Holdings of covered bonds by ADIs

In some European jurisdictions, some covered bonds can receive a preferential risk-weight for capital adequacy purposes relative to other instruments with an equivalent credit rating. This reflects particular historical aspects of the approach to regulating covered bonds in those jurisdictions. As credit rating agencies take the secured nature of covered bonds into account when rating covered bonds, APRA does not intend to provide a similar concession for holdings of covered bonds by ADIs.

Chapter 3 – Holdings of subordinated tranches of non-originated securitisations

APRA is proposing changes to APS 120 to amend the prudential treatment of holdings of subordinate tranches of securitisations held by an ADI other than the originator of the instruments. This matter is unrelated to covered bonds but has been included in this discussion paper for convenience.

APRA intends to extend the operation of the existing alternative capital treatment for securitisations, set out in its letter to ADIs of 10 December 2010³, until it completes a review of its prudential requirements for securitisation. The alternative capital treatment allows ADIs to elect to deduct such holdings from Tier 1 capital as an alternative to holding capital against the pool of assets as if they were on-balance sheet in accordance with APS 112 or APS 113 as appropriate. APRA intends that to undertake its review of the prudential requirements for securitisation during 2012.

ADIs cannot seek to circumvent the requirements of APS 120 for significant risk transfer by exchanging subordinated notes with other ADIs. APRA considers that such arrangements would be an artificial construct designed to circumvent prudential requirements. It foreshadowed its concerns about such arrangements in a letter to ADIs on 26 August 2010.⁴

From a prudential perspective, subordinated tranches of securitisations have many characteristics in common with an equity investment. Consequently, APRA intends to modify APS 120 to require that, where an ADI holds subordinated notes in a securitisation originated by another entity, the amount of such holding should be deducted from Tier 1 capital. For these purposes, APRA intends to define a subordinated tranche as any tranche that has an exposure to the first 10 per cent of credit losses of a securitisation and is not the most senior tranche. The 10 per cent threshold is to be assessed at the time of the securitisation.

APRA proposes that these changes would be incorporated into APS 120 with effect from 1 January 2012. A transitional period of 12 months (until 1 January 2013) is proposed for existing holdings of subordinated notes in third-party securitisations, during which the current capital treatment may continue to be applied.

³ The letter is available at: www.apra.gov.au/adi/Documents/Regulatory-Capital-Treatment-For-Securitisation.pdf

⁴ This letter is available at: www.apra.gov.au/adi/Documents/cfdocs/Securitisation-Letter-to-ADIs-FINAL-26-August-2010.pdf

Chapter 4 – 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 proposed covered bond prudential standard, the proposed change to the capital treatment of subordinated tranches of non-originated securitisations and any other substantive costs associated with the proposed reforms. 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 regulations relating to ADI capital adequacy 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.

Respondents are requested to use the Business Cost Calculator (BCC) to estimate costs to ensure that the data supplied to APRA can be aggregated and used in an industry-wide assessment. APRA would appreciate being provided with the input to the BCC as well as the final result. The BCC can be accessed at www.finance.gov.au/obpr/bcc/index.html.

Appendix 1

Amendments to other prudential standards⁵

APS 120 Securitisation

Replace the existing paragraphs 7⁶ and 8 of the January 2012 version of APS 120 with the following:

7. A covered bond (as defined in the Banking Act) is not a securitisation for the purposes of this Prudential Standard.
8. (a) An ADI must consult with APRA prior to entering into a funding arrangement (other than a covered bond that complies with *Prudential Standard APS 121 Covered Bonds* (APS 121) or a securitisation that complies with all the provisions of this Prudential Standard including the operational requirements for regulatory capital relief in Attachment B to this standard and for which the ADI is seeking capital relief) that involves providing an interest in, or over, assets originated by the ADI, to the funding provider. The ADI must assess the proposal in detail and must establish, to APRA's reasonable satisfaction, that the arrangement:
 - (i) complies with this Prudential Standard and that the ADI is seeking to treat it as an on-balance sheet arrangement; or
 - (ii) does not give the funding provider, even in limited or unlikely circumstances, effective recourse to both the ADI and the pool of assets for repayment (unless it is a covered bond issued or originated by an overseas Level 2 entity in accordance with the requirements of its regulator); or
 - (iii) does not reduce the protection available to depositors of the ADI on either a going-concern or default basis (unless it is a covered bond).
- (b) Where an ADI wishes to enter into an arrangement described in paragraph 8(a) and cannot meet any of the tests in subparagraphs 8(a)(i) to 8(a)(iii), it must apply to APRA for approval to enter into the arrangement. APRA may, if there are exceptional circumstances, approve the arrangement and if it does so, may impose an appropriate regulatory capital treatment for the transaction.
- (c) Where an ADI has entered into a structure prior to 1 January 2012 that does not meet any of the tests in subparagraphs 8(a)(i) to 8(a)(iii), it must apply to APRA for approval of this arrangement. APRA may, if there are exceptional circumstances, approve the arrangement and, if it does so, January 2012 may impose an appropriate regulatory capital treatment for the transaction.

APS 110 Capital adequacy

Insert the following heading and paragraph 14 and renumber subsequent paragraphs

Assets and liabilities of covered bond special purpose vehicles

14. For the purposes of measuring an ADI's capital adequacy, large exposures and exposures to related entities all assets and liabilities of a covered bond special purpose vehicle are to be treated as assets and liabilities of the issuing ADI (as defined in the Banking Act), except as specified below:
 - (a) where Prudential Standard *APS 121 Covered Bonds* (APS 121) provides that an asset, liability or amount is to be treated in a particular manner, then it is to be so treated;

⁵ All references to amendments are to the January 2012 Prudential Standards, incorporating enhancements to the Basel II Framework in Australia as announced on 23 May 2011.

⁶ The amendment to paragraph 7 took effect on 26 October 2011.

- (b) liabilities from a covered bond special purpose vehicle to the issuing ADI are to be disregarded;
- (c) liabilities from the issuing ADI to the covered bond special purpose vehicle are to be disregarded.

APS 111 Capital adequacy: measurement of capital

Insert the following heading and clause as subparagraph 39(s)

Excess assets in cover pools

- (s) The value of excess assets in cover pools as provided by *Prudential Standard APS 121 Covered Bonds* (APS 121).

Insert the following heading and clause as subparagraph 44(s)

Excess assets in cover pools

- (s) The value of excess assets in cover pools as provided by *Prudential Standard APS 121 Covered Bonds* (APS 121).

APS 112 Capital adequacy: standardised approach to credit risk

Replace paragraph 5 with the following

5. The following items are excluded from the scope of this Prudential Standard:
 - (a) assets or investments that are required to be deducted from Tier 1 and/or Tier 2 capital under *Prudential Standard APS 111 Capital Adequacy: Measurement of Capital* (APS 111);
 - (b) securitisation exposures which are subject to the requirements of *Prudential Standard APS 120 Securitisation* (APS 120); and
 - (c) assets of a covered bond special purpose vehicle not specified to be treated as assets of the ADI by section 31D of the *Banking Act* or *Prudential Standard APS 121 Covered Bonds* (APS 121).

APS 113 Capital adequacy: Internal ratings-based approach to credit risk

Replace paragraph 5 with the following

5. The following items are excluded from the scope of this Prudential Standard:
 - (a) assets or investments that are required to be deducted from Tier 1 and/or Tier 2 capital under *Prudential Standard APS 111 Capital Adequacy: Measurement of Capital* (APS 111);
 - (b) securitisation exposures which are subject to the requirements of *Prudential Standard APS 120 Securitisation* (APS 120); and
 - (c) assets of a covered bond special purpose vehicle not specified to be treated as assets of the ADI by section 31D of the *Banking Act* or *Prudential Standard APS 121 Covered Bonds* (APS 121).

APS 116 Capital adequacy: Market risk

Proposed addition of clause 4(c)

4. This Prudential Standard applies to all:
 - (a) trading book positions;
 - (b) banking and trading book positions that give rise to foreign exchange or commodity risks; and
 - (c) assets of a covered bond special purpose vehicle not specified to be treated as assets of the ADI by section 31D of the *Banking Act* or *Prudential Standard APS 121 Covered Bonds* (APS 121).

For the purposes of this Prudential Standard, no distinction is drawn, in principle, between risks arising from physical positions and from positions in derivative instruments.

APS 221 Large exposures

Insert the following as a new clause 4 and renumber subsequent paragraphs

4. For the purposes of this standard, exposures of a covered bond special purpose vehicle are to be treated as specified in paragraph 14 of *Prudential Standard APS 110 Capital Adequacy* (APS 110).

APS 222 Associations with Related Entities

Insert the following as a new clause 4 and renumber subsequent paragraphs

4. For the purposes of this standard, exposures of a covered bond special purpose vehicle are to be treated as specified in paragraph 14 of *Prudential Standard APS 110 Capital Adequacy* (APS 110).



Telephone
1300 55 88 49

Email
info@apra.gov.au

Website
www.apra.gov.au

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