



18 November 2011

To all locally incorporated authorised deposit-taking institutions

SECURITISATION

Pre-approval of securitisations

Paragraph 18 of *Prudential Standard APS 120 Securitisation* (APS 120) (paragraph 20 from 1 January 2012) requires that ADIs undertake a written self-assessment for each securitisation in which the ADI participates, demonstrating compliance with the requirements of APS 120. It is essential that these self-assessments are rigorous, of a high quality and consider the economic substance of the transaction.

If a securitisation satisfies all of the requirements of APS 120, including the operational requirements for capital relief set out in Attachment B to APS 120, it does not need to have prior written approval from APRA. Similarly, prior approval is not necessary where:

- an ADI retains the subordinated tranche(s) in a securitisation so that the securitisation meets all of the requirements of APS 120 except the requirement for significant credit risk transfer; and
- the ADI intends to treat the securitised loans as if on-balance sheet.

Regulatory capital treatment

On 10 December 2010, APRA wrote to ADIs to advise that it was prepared to approve an alternative capital treatment to that required under APS 120 for securitisations where the issuing ADI retains the subordinated tranche(s) of a securitisation. The alternative capital treatment allows the originating ADI to deduct these subordinated holdings from Tier 1 capital. This approach is consistent with the intent of APS 120 and it was indicated that this interim arrangement would apply until 1 January 2012.

APRA intends to review APS 120 during 2012. Accordingly, APRA will permit ADIs to continue to use the alternative capital treatment until that review is complete.

ADIs are reminded that the alternative capital treatment will only be permitted where an ADI has APRA's prior written approval and the securitisation complies with all of the requirements of APS 120 apart from significant credit risk transfer, due to the ADI holding the subordinated tranche(s).

The requirement for prior written approval before applying the alternative capital treatment reflects the fact that APRA does not require the securitised loans to be treated as if on-balance sheet. Where APRA has approved the use of the alternative capital treatment for an existing securitisation, the ADI may continue to apply this treatment to that securitisation pending completion of APRA's review of APS 120.

Risk-weighting

Some ADIs have asked under what circumstances APRA considers that transferring mortgages to a securitisation vehicle prevents the assignment of a risk-weight of less than 100 per cent to the securitised loans under Attachment C of *Prudential Standard APS 112 Capital Adequacy: Standardised Approach to Credit Risk* (APS 112).

Pending its review of APS 120, APRA is willing to treat a securitisation structure as consistent with a risk-weight of less than 100 per cent if:

- the securitisation is a contingent liquidity securitisation arrangement; or
- the securitisation complies with all aspects of APS 120, including the requirements for capital relief but the ADI is electing to treat the securitised loans as if on-balance sheet; or
- the securitisation complies with all aspects of APS 120 except for significant credit risk transfer due to the ADI holding notes in subordinated tranche(s).

Subordinated tranches issued by other entities

APRA has previously noted its concern about ADIs purchasing subordinated tranche(s) of securitisations from third-party originators. Accordingly, APRA is considering a proposal to modify APS 120 to require that where an ADI holds subordinated tranche(s) in a securitisation originated by another entity, the amount of such holding should be deducted from Tier 1 capital (Core Equity Tier 1 from 1 January 2013). This proposal is contained in the discussion paper *Covered bonds and securitisation matters*, which was released on 8 November 2011. ADIs are encouraged to consider the proposals in that discussion paper and provide submissions by 9 December 2011.

If you have any questions regarding these matters, please contact your APRA Responsible Supervisor.

Yours sincerely



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