



## **Prudential Standard APS 221**

### **Large Exposures**

#### **Objectives and key requirements of this Prudential Standard**

This Prudential Standard requires authorised deposit-taking institutions to implement prudent measures and to set prudent limits to monitor and control their large exposures and risk concentrations.

The key requirements of this Prudential Standard are that an authorised deposit-taking institution must:

- have a Board-approved policy that governs its large exposures and risk concentrations;
- have adequate systems and controls to identify, measure, monitor and report large exposures and risk concentrations;
- identify connected counterparties;
- ensure its large exposures meet the large exposure limits; and
- measure exposure values for large exposure purposes using specified treatments.

**Table of Contents**

Authority.....3

Application .....3

Interpretation.....3

Definitions .....4

The role of the Board .....4

Control of large exposures and risk concentrations .....4

Identifying large exposures .....5

Large exposure limits.....9

Measuring large exposure values .....9

Prior notification requirements .....10

Approval requirements.....10

Notification requirements .....10

Significant risk concentrations.....10

Adjustments and exclusions.....11

Previous exercise of discretion .....11

Attachment A—Measuring large exposure values .....12

Attachment B—Group of related counterparties .....18

## Authority

1. This Prudential Standard is made under section 11AF of the *Banking Act 1959* (**Banking Act**).

## Application

2. This Prudential Standard applies to all authorised deposit-taking institutions (**ADIs**), subject to paragraph 3 of this Prudential Standard.
3. This Prudential Standard does not apply to:
  - (a) **purchased payment facility providers**; or
  - (b) **foreign ADIs** that are subject to consolidated supervision by their home country supervisors in respect of credit concentrations and large exposure limits. However, foreign ADIs must detail their large exposure and risk concentration policies as well as the relevant high level controls in the **risk management strategy** required under *Prudential Standard CPS 220 Risk Management* (CPS 220). As part of its prudential oversight of the Australian operations of a foreign ADI, APRA may discuss with the foreign ADI's parent and home supervisor any undue credit risk concentrations associated with the foreign ADI's Australian operations.
4. A reference to an ADI in this Prudential Standard, unless otherwise indicated, is a reference to:
  - (a) an ADI on a **Level 1** basis; and
  - (b) a **group** of which an ADI is a member on a **Level 2** basis.
5. If an ADI to which this Prudential Standard applies is:
  - (a) the holding company for a group, the ADI must ensure that the requirements in this Prudential Standard are met on a Level 2 basis, where applicable; or
  - (b) a **subsidiary** of an authorised **non-operating holding company** (**authorised NOHC**), the authorised NOHC must ensure that the requirements in this Prudential Standard are met on a Level 2 basis, where applicable.
6. This Prudential Standard commences on 1 January 2019.

## Interpretation

7. Terms that are defined in *Prudential Standard APS 001 Definitions* appear in bold the first time they are used in this Prudential Standard.
8. Where this Prudential Standard provides for APRA to exercise a power or discretion, this power or discretion is to be exercised in writing. In this Prudential Standard, unless the contrary intention appears, a reference to an Act, Regulations

or Prudential Standard is a reference to the Act, Regulations or Prudential Standard as in force from time to time.

## Definitions

9. The following definitions are used in this Prudential Standard:
- (a) *government-related entity* means a public sector entity, a state-owned enterprise or an entity controlled (whether directly or indirectly) by any level of government or a central bank;
  - (b) *group of connected counterparties* has the meaning given in paragraph 20 of this Prudential Standard; and
  - (c) *retail exposure* means an exposure to a counterparty who is a natural person or for an ADI subject to *Prudential Standard APS 113 Capital Adequacy: Internal Ratings-based Approach to Credit Risk* (APS 113) an exposure categorised as a retail exposure for the purposes of APS 113.

## The role of the Board

10. The Board of directors (**Board**) of an ADI is ultimately responsible for the oversight of the ADI's large exposures and risk concentrations and for approving policies governing large exposures and risk concentrations of the ADI. The Board must **ensure** that these policies are reviewed regularly (at least annually) and that they remain adequate and appropriate for the ADI's risk appetite, risk profile, capital and balance sheet size.

## Control of large exposures and risk concentrations

11. An ADI's large exposures and risk concentrations policy must give consideration to particular counterparties, groups of connected counterparties, industries, countries and asset classes and form part of the ADI's risk management strategy and **risk management framework** required under CPS 220. Unlimited exposures to any individual counterparty (e.g. a general guarantee of the obligations of a counterparty) is not permitted.
12. An ADI's policies on large exposures and risk concentrations must, at a minimum, cover:
- (a) exposure limits for:
    - (i) various types of counterparties (including, but not limited to, governments, government-related entities, ADIs and foreign equivalents, corporate and individual borrowers and credit risk mitigation (CRM) providers);
    - (ii) groups of connected counterparties;
    - (iii) individual industry sectors (where applicable);

- (iv) individual countries (where applicable). The limits for individual countries should consider, amongst other things, any potential transfer risks where a borrower is not able to convert local currency into foreign exchange and consequently would be unable to make debt service payments to the ADI. This risk can arise from exchange restrictions imposed by the government in the borrower's country; and
  - (v) various asset classes,  
that are commensurate with the ADI's risk appetite, risk profile, capital and balance sheet size;
  - (b) the circumstances in which the exposure limits may be exceeded and the authority and processes required for approving such excesses (e.g. by the ADI's Board or a board committee);
  - (c) the process for identifying, measuring, evaluating, monitoring, controlling and reporting large exposures and risk concentrations of the ADI; and
  - (d) stress testing and scenario analysis of the ADI's large exposures and risk concentrations to assess the impact of changes in market conditions and key risk factors (e.g. economic cycles, interest rates, liquidity conditions or other market movements) on its risk profile, capital and earnings.
13. An ADI must ensure that:
- (a) adequate systems and controls are in place to identify, measure, monitor and report large exposures and risk concentrations of the ADI in a timely manner; and
  - (b) large exposures and risk concentrations of the ADI are reviewed at least annually.
14. Certain types of exposures and counterparties are excluded from the prudential limits in paragraph 30 of this Prudential Standard. An ADI must have adequate processes and controls in place to monitor these excluded exposures. An ADI is expected to consider how the risks arising from these types of exposures are incorporated into its risk management framework under CPS 220, including establishing internal limits and triggers commensurate with its risk appetite.

### **Identifying large exposures**

15. An exposure to an individual counterparty or a group of connected counterparties is the aggregate of all claims, commitments and contingent liabilities arising from on- and off-balance sheet transactions (in both the banking and trading books) with the individual counterparty or group of connected counterparties and is measured in accordance with paragraphs 32 to 33 of this Prudential Standard.
16. A large exposure is an exposure to an individual counterparty or a group of connected counterparties (defined in paragraphs 20 to 29 of this Prudential

Standard) that is greater than, or equal to, 10 per cent of an ADI's **Tier 1 Capital** at either Level 1 or Level 2.<sup>1</sup>

17. A large exposure is one form of exposure that contributes to an ADI's risk concentrations. Exposures to other sources of risk concentrations (e.g. commodities, currencies, sectors, geographies, funding sources) are not subject to the large exposure requirements in paragraphs 18 to 38 of this Prudential Standard.
18. A large exposure excludes:
  - (a) exposures deducted from an ADI's **Regulatory Capital** (in accordance with *Prudential Standard APS 111 Capital Adequacy: Measurement of Capital* (APS 111));<sup>2</sup>
  - (b) exposures to the extent that they have been written off;
  - (c) exposures to the Australian Government or any Australian dollar exposure to the Reserve Bank of Australia (RBA);
  - (d) exposures to governments or central banks that are held as HQLA under *Prudential Standard APS 210 Liquidity* (APS 210);
  - (e) exposures to governments or central banks which arise from the decomposition of derivatives into positions in accordance with Attachment B of *Prudential Standard APS 116 Capital Adequacy: Market Risk* (APS 116) that do not reflect a credit exposure to the government or central bank;
  - (f) intra-day interbank exposures;
  - (g) exposures arising in the course of settlement of market-related contracts unless the transaction remains unsettled after its delivery due date in which case the exposure value is the positive current exposure amount;
  - (h) exposures to qualifying central counterparties (QCCPs) relating to clearing activities (where QCCPs are defined in *Prudential Standard APS 112 Capital Adequacy: Standardised Approach to Credit Risk* (APS 112)); and
  - (i) exposures to **LMI** arising from insured mortgages.<sup>3</sup>
19. Where an exposure that has been excluded is hedged by a credit derivative, an ADI must recognise an exposure to the counterparty providing the credit protection in line with paragraph 5 of Attachment A of this Prudential Standard.

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<sup>1</sup> For the avoidance of doubt, a reference to a counterparty includes a structured vehicle.

<sup>2</sup> Exposures which are 1250 per cent risk-weighted under APS 112 are subject to the large exposure limits.

<sup>3</sup> In the case of an ADI using the standardised approach to credit risk, insured mortgages are those subject to risk-weights for residential mortgages under paragraph 5 of Attachment D of APS 112.

*Connected counterparties*

20. An ADI must treat a group of connected counterparties as a single counterparty. Until 31 December 2019, group of connected counterparties means a group of related counterparties in Attachment B of this Prudential Standard. On and from 1 January 2020, group of connected counterparties has the meaning in paragraph 21 of this Prudential Standard. Paragraphs 21 to 29 of this Prudential Standard have no effect before 1 January 2020.
21. A group of connected counterparties exists if:
  - (a) two or more counterparties are linked by:
    - (i) a control relationship (refer to paragraph 22 and 23 of this Prudential Standard);
    - (ii) an economic interdependence relationship (refer to paragraph 25 of this Prudential Standard);
    - (iii) other connections or relationships which, according to an ADI's assessment, identifies the counterparties as constituting a single risk; or
  - (b) in relation to investments in structured vehicles, an ADI identifies a third party which contributes to an additional risk factor that is material, under paragraphs 28 to 31 of Attachment A of this Prudential Standard.
22. A control relationship exists between two counterparties if one of the counterparties has direct or indirect control over the other counterparty, or if both counterparties are directly or indirectly controlled by another entity (which may be another counterparty). This includes, but is not limited, to any of the following:
  - (a) the entity can exercise more than 50 per cent of the voting rights over the counterparty;
  - (b) the entity has a voting agreement with other shareholders resulting in control of voting rights over the counterparty;
  - (c) the entity has significant influence on the appointment of persons to or removal of persons from the counterparty's management, board committees or Board; or
  - (d) the entity has significant influence on a **senior manager** or senior management of the counterparty (including influence on the policies of the counterparty).
23. In determining whether a control relationship exists, an ADI must also refer to the criteria in relevant **Australian Accounting Standards** as in force from time to time.
24. For the purposes of paragraph 22 of this Prudential Standard, a government-related entity is not required to be treated as a connected counterparty with:

- (a) the government or central bank that controls it; or
  - (b) other government-related entities controlled by the same government or central bank.
25. If an ADI's exposure to a non-retail counterparty exceeds five per cent of the ADI's Tier 1 Capital, the ADI must identify all non-retail counterparties linked by an economic interdependence relationship to that counterparty. An economic interdependence relationship exists between two counterparties if, in the ADI's assessment, the financial soundness of a counterparty could materially affect the financial soundness of another counterparty. This includes, but is not limited to, any of the following:
- (a) 50 per cent or more of a counterparty's annual gross receipts or gross expenditures is derived from transactions with the other counterparty;
  - (b) one counterparty has fully or partly guaranteed the exposure of the other counterparty, or is liable by other means, and the exposure is significant, such that the guarantor is likely to default if a claim occurs;
  - (c) a significant part of a counterparty's business is transacted with the other counterparty, which cannot be easily replaced by business from other customers within a reasonable time period;
  - (d) the expected source of funds to repay the loans of both counterparties is the same and neither counterparty has another independent source of income from which the loans may be fully repaid;
  - (e) it is likely that the financial difficulties of one counterparty would cause difficulties for the other counterparty in terms of full and timely repayment of liabilities;
  - (f) the insolvency or default of one counterparty is likely to be associated with the insolvency or default of the other counterparty; or
  - (g) the counterparties rely on the same source for the majority of their funding and, in the event of the common funds provider's default, it is expected that an alternative funds provider could not be found.
26. An ADI is not required to include a counterparty in a group of connected counterparties under paragraph 25 of this Prudential Standard if the ADI is satisfied that the counterparty is able to overcome financial difficulties (including as a result of a default by other counterparties in the group) by finding alternative business partners or funding sources within a reasonable time period.
27. Exposures to central counterparties (CCPs) that are specifically related to clearing activities may be excluded when measuring exposures to a group of connected counterparties.
28. An ADI must review the reasons for not treating certain counterparties (including structured vehicles and third parties which contribute additional risk factors) as a group of connected counterparties in a timely manner.



29. APRA may require an ADI to treat counterparties as a group of connected counterparties if in APRA's view they meet the criteria in paragraph 21 of this Prudential Standard.

### Large exposure limits

30. The aggregate large exposures of an ADI to a counterparty or a group of connected counterparties must not exceed 25 per cent of the ADI's Tier 1 Capital, except:
- (a) exposures to foreign governments or central banks that receive a zero per cent risk-weight in accordance with Attachment A of APS 112, which must not exceed 50 per cent of the ADI's Tier 1 Capital;<sup>4</sup> and
  - (b) where the ADI has been determined by APRA to be a domestic systemically important bank (D-SIB), exposures to any other ADI determined by APRA to be a D-SIB must not exceed 20 per cent of the ADI's Tier 1 Capital.<sup>5</sup>

These limits apply to an ADI's large exposures at both Level 1 and Level 2 net of eligible CRM techniques and excluded exposures under paragraph 18 of this Prudential Standard.<sup>6</sup>

31. Notwithstanding paragraph 30 of this Prudential Standard, APRA may set specific limits on an ADI's exposures to particular counterparties, groups of connected counterparties, industry sectors, countries or asset classes, including property holdings and any other investments, having regard to the ADI's individual circumstances.

### Measuring large exposure values

32. An ADI must measure exposure values in accordance with Attachment A of this Prudential Standard. In measuring large exposures, an ADI must include all on-balance sheet exposures and off-balance sheet exposures in both the banking book and trading book and instruments that would give rise to counterparty credit risk (CCR) under draft *Prudential Standard APS 180 Capital Adequacy: Counterparty Credit Risk* (draft APS 180).<sup>7</sup>
33. APRA may determine the exposure value of a particular on-balance sheet or off-balance sheet exposure of an ADI if APRA considers that the ADI has not appropriately assessed the exposure.

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<sup>4</sup> Paragraph 30(a) includes exposures guaranteed by, or secured against securities issued by, foreign governments or central banks that receive a zero per cent risk weight under Attachment A of APS 112, provided the criteria for recognition of the credit risk mitigation in paragraphs 2 to 3 of Attachment A are met.

<sup>5</sup> Refer to [Information Paper - Domestic systemically important banks in Australia](#) as at December 2013.

<sup>6</sup> Prudential limits on an ADI's exposures to related entities are set out in *Prudential Standard APS 222 Associations with Related Entities*.

<sup>7</sup> Refer to draft Prudential Standard APS 180 Capital Adequacy: Counterparty Credit Risk as it exists at 3 August 2017.

### **Prior notification requirements**

34. An ADI must notify APRA prior to committing to any proposed large exposures to non-government and non-ADI counterparties, subject to paragraph 35 of this Prudential Standard.
35. APRA may determine that an ADI is not required to notify APRA about proposed exposures that are below a specified threshold, having regard to the robustness of the ADI's credit risk management framework.

### **Approval requirements**

36. An ADI must obtain approval from APRA prior to undertaking any proposed exposures which would exceed the large exposure limits under paragraph 30 of this Prudential Standard or any specific limits determined under paragraph 31 of this Prudential Standard. Such approval will only be granted on an exceptions basis taking into consideration the individual circumstances of the ADI and the ADI's assessment of:
  - (a) the concentration risks involved with exceeding the large exposure limits and why the proposed exposures will not unreasonably expose the ADI to excessive risk; and
  - (b) how the proposed exposures are consistent with its large exposures and risk concentration policies.

### **Notification requirements**

37. An ADI must notify APRA immediately of any breach of the large exposure limits under paragraph 30 of this Prudential Standard or any specific limits determined by APRA under paragraph 31 of this Prudential Standard (other than those where APRA has provided an approval under paragraph 36 of this Prudential Standard), including how the breach arose and remedial actions taken or planned to be taken to deal with the breach.
38. An ADI must notify APRA immediately where it has concerns that its large exposures or risk concentrations have the potential to have a material impact on its capital adequacy and provide details of the proposed measures to address these concerns.

### **Significant risk concentrations**

39. Where an ADI has a number of large exposures or where APRA is of the view that the ADI is exposed to a significant level of risk concentration, APRA may:
  - (a) require the ADI to maintain higher **Prudential Capital Requirements (PCRs)** at Level 1 or Level 2 or both. In considering whether an ADI's PCRs should be increased, APRA will take into account:
    - (i) the consistency of the ADI's exposures with the ADI's large exposures and risk concentrations policies;

- (ii) the number of exposures, their individual size and nature; and
  - (iii) the characteristics of the ADI, including the nature of its business and the experience of its management;
- (b) impose higher risk-weights in relation to those exposures; or
- (c) require an ADI to take measures to reduce its level of risk concentration.

### **Adjustments and exclusions**

40. APRA may adjust or exclude a specific prudential requirement in this Prudential Standard in relation to one or more specified ADIs or authorised NOHCs.<sup>8</sup>

### **Previous exercise of discretion**

41. An ADI must contact APRA if it seeks to place reliance, for the purposes of complying with this Prudential Standard, on a previous exemption or other exercise of discretion by APRA under a previous version of this Prudential Standard.

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<sup>8</sup> Refer to subsection 11AF(2) of the Banking Act.

## Attachment A—Measuring large exposure values

1. The exposure value to be used in measuring large exposures is:
  - (a) for banking book on-balance sheet non-derivative assets, the accounting value of the exposure that is net of specific provisions and value adjustments. An ADI may only use exposure values gross of specific provisions and value adjustments with prior agreement from APRA;
  - (b) for instruments that give rise to CCR held in the banking book and trading book (excluding securities financing transactions (SFTs)),<sup>9</sup> the exposure at default as measured under draft APS 180;
  - (c) for SFTs, the exposure value calculated using Attachments H and J of APS 112; and
  - (d) for banking book commitments, all committed exposures i.e. drawn on-balance sheet commitments and undrawn off-balance sheet commitments. Off-balance sheet commitments are to be converted into credit equivalent amounts by applying a 100 per cent conversion factor.

### Credit risk mitigation

2. Eligible CRM techniques for large exposure purposes are those which are allowed in APS 112. Forms of collateral that are only eligible under the internal ratings-based approach in APS 113 are not permitted to be used in reducing exposure values for large exposure purposes.
3. An ADI must apply an eligible CRM technique in measuring exposures if the eligible CRM technique has been used in calculating the ADI's capital requirements.
4. Where paragraph 3 of this Attachment applies, an ADI must reduce the exposure value to a counterparty by the amount determined by applying the eligible CRM technique, being:
  - (a) for guarantees and credit derivatives, the value of the protected amount;
  - (b) when the ADI uses the simple approach to the recognition of collateral in Attachment H of APS 112, the value of the part of the claim collateralised by the market value of the recognised eligible collateral;
  - (c) for any instruments with CCR, the value of the collateral as recognised in the calculation of the CCR exposure value; and
  - (d) in the case of eligible collateral when the ADI applies the comprehensive approach to the recognition of collateral in Attachment H of APS 112, the

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<sup>9</sup> SFTs are defined in paragraph 9 of APS 112.

value of the collateral adjusted after applying supervisory haircuts. ADIs must not use internally modelled haircuts.

5. When the exposure value to a counterparty is reduced due to an eligible CRM technique, an ADI must also recognise an exposure to the CRM provider equal to the amount that the exposure value to the original counterparty was reduced (except for credit protection in the form of a credit default swap (CDS), which must be treated in accordance with paragraph 17(b) of this Attachment).
6. If there is a maturity mismatch in respect of credit risk mitigants, the credit protection, for the purpose of calculating an ADI's large exposures, must be adjusted using the requirements in Attachments G, H and I of APS 112.<sup>10</sup>

#### **On-balance sheet netting**

7. Where an ADI has legally enforceable netting arrangements in place for loans and deposits, an ADI must use net credit exposures subject to the requirements for on-balance sheet netting for loans and deposits under Attachment J of APS 112.

#### **Exposure values for trading book positions**

8. An ADI must aggregate banking book and trading book exposures to determine its total exposure to an individual counterparty.
9. The exposure value for non-derivative debt instruments and equity instruments is the accounting value of the exposure i.e. the market value.
10. The exposure value for swaps, futures, forwards and credit derivatives is calculated by converting the instruments into positions in accordance with Attachment B of APS 116 such that these instruments are decomposed into their individual legs. An ADI is to recognise only those transaction legs for which exposures are not excluded under paragraph 18 of this Prudential Standard.
11. For credit derivatives that represent sold protection, the exposure to the referenced name is the amount due in the case that the referenced name triggers the instrument less the absolute market value of the credit protection.<sup>11</sup> For credit-linked notes, the protection seller must consider positions in the bond of the note issuer as well as in the underlying credit referenced by the note.

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<sup>10</sup> Attachments G, H and I of APS 112 only recognise CRM with maturity mismatches when their original maturities are greater than or equal to 12 months and the residual maturity of the CRM is more than three months.

<sup>11</sup> Where the market value of the credit derivative is positive for the protection seller, the positive market value must be added to the exposure of the protection seller to the protection buyer, such as in the case where the present value of already agreed but not yet paid periodic premiums exceed the absolute market value of the credit protection.

12. For the purposes of this Prudential Standard, the exposure value of an option is calculated as the change in the option value that would result from a default of the respective underlying instrument as follows:<sup>12</sup>
  - (a) for a call, the exposure is the market value of the option. For a long call this is a positive value whereas for a short call this is a negative value; and
  - (b) for a put, the exposure value is the option's strike price less the market value of the option. For a short put this is a negative value whereas for a long put this is a positive value.

An ADI must aggregate the resulting option exposures to each underlying counterparty. If there is a negative net exposure after aggregation of all option exposures, the option exposure must be set to nil.

13. An ADI's exposure to transactions (e.g. index positions, securitisations, hedge funds, investment funds) must be calculated according to the requirements for similar instruments in paragraphs 21 to 31 of this Attachment. This may result in the exposure value being assigned to a structured vehicle itself and treated as a distinct counterparty, to counterparties corresponding to the underlying assets or to an aggregated unknown exposure amount (which is treated as applying to a distinct counterparty to the ADI) when the ADI is unable to identify underlying assets.

#### **Offsetting long and short positions in the trading book in the same issue**

14. An ADI may offset long and short positions in the same issue i.e. if the issuer, coupon, currency and maturity are identical resulting in a net position in that specific issue in order to calculate its exposures to a particular issuer.

#### **Offsetting long and short positions in the trading book in different issues**

15. An ADI may offset positions in different issues from the same issuer only when the short position is junior to, or ranks pari passu with, the long position. An ADI may allocate securities into broad categories of seniority (e.g. equity, subordinated debt and senior debt) to determine the relative seniority of positions.
16. An ADI must not offset long and short positions in different issues relating to the same issuer in calculating its exposure values if it determines that allocation by seniority is not feasible.
17. For positions hedged by credit derivatives:
  - (a) the hedge may be recognised provided the underlying of the hedge and the position hedged satisfy the requirement in paragraph 15 of this Attachment; and
  - (b) any reduction in exposure to the original counterparty must result in a new exposure to the credit protection provider (in accordance with paragraph 5

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<sup>12</sup> The treatment of options for large exposure purposes is different to the exposure values used for options in calculating capital requirements in APS 116.

of this Attachment), except where the credit protection is in the form of a CDS and either the CDS provider, or the entity to which the credit protection applies, is not a **financial institution**. In this situation, the amount assigned to the CDS provider is the CCR exposure calculated under draft APS 180.

18. An ADI is not permitted to offset trading book positions against banking book positions.
19. When the result of offsetting in the trading book is a net short position with an individual counterparty, this net short position does not need to be considered as an exposure for the purposes of this Prudential Standard.

#### **Exposure values for covered bonds**

20. An ADI must calculate the exposure value for a covered bond using the full (i.e. 100 per cent) nominal value of its covered bond holding.<sup>13</sup> The counterparty to which the exposure value is assigned is the issuer of the covered bond.

#### **Exposures to structured vehicles**

21. Paragraphs 22 to 31 of this Attachment are effective from 1 January 2020.
22. An ADI must calculate an exposure to a structured vehicle (e.g. funds, securitisation vehicles, structured finance products) which holds non-retail assets using the look-through requirements in paragraphs 23 to 27 of this Attachment.
23. Where an ADI's exposure to a structured vehicle is less than 0.25 per cent of the ADI's Tier 1 Capital, or the ADI can demonstrate that all the underlying assets of the structured vehicle are less than 0.25 per cent of the ADI's Tier 1 Capital, an ADI must assign an exposure value to the structured vehicle equal to the nominal exposure it has to the structured vehicle. In this case, an ADI is not required to look through the structured vehicle to identify the underlying assets.
24. Where an ADI's exposure value to at least one of the underlying assets of the structured vehicle is greater than or equal to 0.25 per cent of the ADI's Tier 1 Capital, the ADI must assign an exposure value to the structured vehicle equal to the nominal amount it invests in the structured vehicle and:
  - (a) for each underlying asset of the structured vehicle that can be identified and that has an exposure value greater than or equal to 0.25 per cent of the ADI's Tier 1 Capital, the ADI must look through the structured vehicle and assign the exposure values to the counterparties for each of the underlying assets; and
  - (b) for each underlying asset of the structured vehicle that cannot be identified and that has an exposure value greater than or equal to 0.25 per cent of the ADI's Tier 1 Capital, the ADI must assign the exposure value to an unknown counterparty which is treated as a distinct counterparty to the ADI. An ADI must aggregate unknown counterparties across its exposures

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<sup>13</sup> Covered bonds are defined in *Prudential Standard APS 121 Covered bonds*.

to structured vehicles as if they relate to a single counterparty to which large exposure limits would apply under paragraph 30 of this Prudential Standard.

25. When an ADI has applied the look-through requirements for a structured vehicle under paragraph 24 of this Attachment, and all investors in the structured vehicle rank *pari passu*, the exposure value assigned to each counterparty is equal to the pro rata share that the ADI holds in the structured vehicle multiplied by the value of the underlying assets.
26. When an ADI has applied the look-through requirements for a structured vehicle under paragraph 24 of this Attachment, and there are different seniority levels among investors in the structured vehicle, the exposure value to a counterparty must be measured for each tranche within the structured vehicle assuming a pro rata distribution of losses amongst investors in a single tranche. To measure the exposure value in the underlying assets, the ADI must:
  - (a) identify the lower of the value of the tranche in which an ADI has an exposure to and the nominal value of each underlying asset included in the underlying portfolio of assets; and
  - (b) apply the pro rata share of the ADI's exposure in the tranche to the value determined in paragraph 26(a) of this Attachment.
27. When an ADI has not applied the look-through requirements for an exposure to a structured vehicle it must assess the risk concentrations of the underlying assets of the structured vehicle on an annual basis.

*Additional risk factor*

28. An ADI must identify third parties which contribute to an additional risk factor inherent in the structured vehicle itself rather than in the assets held by the vehicle. Third parties may include, but are not limited to, fund managers, originators, liquidity providers and credit protection providers. This applies regardless of whether an ADI has applied the look-through requirements in paragraphs 23 to 27 of this Attachment.
29. An ADI must treat structured vehicles as a group of connected counterparties if they share one or more common additional risk factors that pose material risks to the ADI's exposures to these structured vehicles.
30. Where an ADI identifies more than one third party as a driver of a particular additional risk factor, the ADI must assign the exposure in the structured vehicles to each of the third parties if they pose material risks to the structured vehicles.
31. An ADI must add its exposures to a structured vehicle associated with a third party deemed to contribute to an additional risk factor to other exposures that the ADI has to that third party if:
  - (a) there is a material risk to the exposures in the structured vehicle if the third party were to default on a direct exposure to the ADI; or



- (b) there is a material risk to a direct exposure to that third party if the third party were to default in its role in the structured vehicles.

**Exposure values for non-qualifying central counterparties and clearing activity exposures**

- 32. An ADI must measure its exposure to non-qualifying CCPs as the sum of clearing exposures (determined in accordance with paragraph 33 of this Attachment) and non-clearing exposures (determined in accordance with paragraph 35 of this Attachment). This aggregate exposure is subject to the large exposure limits in paragraph 30 of this Prudential Standard.
- 33. Clearing exposures to a non-qualifying CCP are calculated as:
  - (a) for trade exposures, the exposure measure corresponding to trading book exposure value determined in accordance with APS 112;
  - (b) for non-segregated initial margin, the nominal amount of initial margin posted;
  - (c) for pre-funded default fund contributions, the funded contribution; and
  - (d) for equity stakes, the nominal amount.

Clearing exposures to a non-qualifying CCP in relation to segregated initial margin and unfunded default fund contributions are excluded.

- 34. When an ADI acts as a clearing member to a CCP or is a client of a clearing member, the counterparty to which exposures are assigned must be determined in accordance with draft APS 180.
- 35. Non-clearing exposures to a non-qualifying CCP are all exposures to a non-qualifying CCP not directly related to the provision of clearing services (e.g. funding facilities, credit facilities, and guarantees).

## **Attachment B—Group of related counterparties**

1. This Attachment is effective until 31 December 2019.
2. A group of related counterparties is deemed to exist where two or more individual counterparties are linked by:
  - (a) cross guarantees;
  - (b) common ownership or management;
  - (c) the ability to exercise control over the other(s), whether direct or indirect;
  - (d) financial interdependency such that the financial soundness of any of them may affect the financial soundness of the other(s); or
  - (e) other connections or relationships which, according to an ADI's assessment, identify the counterparties as constituting a single risk.

As a general rule, family members are not required to be treated as connected where they have independent retail relationships with an ADI.