



20 July 2011

To all locally incorporated Authorised Deposit-taking Institutions

## IMPLEMENTATION OF BASEL II ENHANCEMENTS FOR SECURITISATION

The enhancements to the Basel II Framework released by APRA on 23 May 2011 will become effective on 1 January 2012. Among other elements, the enhancements included substantial changes to *Prudential Standard APS 120 Securitisation* (APS 120) and *Prudential Practice Guide APG 120 Securitisation* (APG 120). This letter seeks feedback on each ADI's plans to ensure that it will be in a position to meet the new securitisation requirements from 1 January 2012.

The key changes to APS 120 are:

- the requirement to perform due diligence on all securitisation exposures;
- the need to identify whether exposures are securitisations or resecuritisations and are classified appropriately;
- operational requirements for the use of external credit assessments; and
- the requirement to obtain APRA approval for secured funding arrangements that are non-complying securitisations (including those where the ADI has not achieved significant credit risk transfer and has been granted approval to use the alternative capital treatment).

The attachment provides further detail on these changes.

Under APS 120 paragraph 19, the Board and senior management of an ADI must establish policies and procedures for its securitisation business. Many of the new detailed requirements in the revised APS 120 (such as the requirement to undertake due diligence) will require specific policies to be established to support them.

Each ADI will need to revise its securitisation policies and procedures and review all existing self-assessments to ensure compliance with the amended APS 120 by 1 January 2012. APRA's expectation is that ADIs should have already started this process.

APG 120 has also been amended to provide additional guidance on the risk management requirements for securitisation (paragraphs 6 to 15). APRA would expect ADIs also to consider the need to augment their policies and procedures (as well as ICAAP assessments) in light of this guidance.

APRA requests that each ADI provide, by 31 August 2011, details of its plans and timelines to ensure full compliance with all the requirements of the new APS 120 by 1 January 2012. Particular aspects to consider when preparing plans and timelines include:

- (i) amending securitisation policies and procedures and the self-assessment process and practices;

- (ii) addressing any issues identified in self-assessments (or other verification) to ensure compliance with APS 120 by 1 January 2012;
- (iii) undertaking new self-assessments (or other verification exercises) for all existing securitisation exposures;
- (iv) amending its APRA reporting procedures to accommodate the changes to the securitisation reporting forms; and
- (v) assessing the likely capital impact of the changes and outlining how the ADI intends to address any adverse capital impacts (such as selling down holdings of mortgage-backed securities where it is considered impractical to undertake a due diligence).

This response should be provided to your APRA Responsible Supervisor, who can also be contacted if you have any questions.

Where an ADI does not currently undertake securitisation and does not plan to commence doing so, you should advise your APRA Responsible Supervisor of this, in writing, by 31 August 2011.

Yours sincerely,



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**Due diligence requirements (APS 120 Attachment B paragraph 13 and APG 120 paragraphs 61 to 63)**

If an ADI does not perform appropriate due diligence on its securitisation exposures, it will have to deduct these exposures wherever they are located within the business (in the trading book, liquidity book etc) from 1 January 2012. Consequently, the due diligence will need to be completed prior to 1 January 2012.

APS 120 Attachment B Paragraph 13 details the information that an ADI must collect on each exposure it wishes to risk-weight. If it does not collect and review this information in a timely manner, it will have to deduct the securitisation or resecuritisation exposure. The ADI must also ensure it has systems and controls in place from 1 January 2012 to collect and review this information on a regular basis.

Where it cannot obtain this information, the entire exposure is deducted.

**Identification of securitisation or resecuritisation (APS 120 paragraph 9(r) and 9(t), APG 120 paragraphs 3 and 60)**

The ADI must determine whether an exposure is a securitisation exposure or a resecuritisation exposure.

A resecuritisation exposure attracts a higher capital charge than an equivalent securitisation exposure. APRA would, therefore, expect the ADI to be able to clearly establish that an exposure is not a resecuritisation if it seeks to apply the securitisation charges. If it is in doubt, it would be expected to take a prudent approach and treat the exposure as a resecuritisation.

**Operational requirements for the use of external credit assessments (APS 120 Attachment B paragraphs 9 to 12)**

An ADI is not allowed to use an external credit risk assessment for risk-weighting purposes where the credit risk assessment is based on unfunded support provided by the ADI. This means that where the ADI provides a liquidity facility or credit enhancement or some other type of support facility to the securitisation (or resecuritisation) and also holds a rated exposure, it must ascertain whether the rating is based on the support provided by the ADI.

A practical example is where the ADI holds rated notes or provides a rated swap to a securitisation and also provides a liquidity facility. If the credit rating relies on the liquidity facility, the ADI cannot use the rating to determine the risk-weight of the swap or the notes.

**Approval of secured funding arrangements (APS 120 paragraph 8, APG 120 Paragraphs 22 and 23)**

APS 120 requires an ADI to consult with APRA prior to entering into a secured funding arrangement other than a complying securitisation for which the ADI is seeking capital relief. The ADI must establish to APRA's satisfaction that the arrangement meets three tests in the standard.

Where the arrangement fails any of the tests, the ADI must obtain prior APRA approval to enter the arrangement. APRA will only give approval in exceptional circumstances and will agree a capital treatment at the time.

These arrangements also apply to structures entered into prior to 1 January 2012. ADIs will therefore need to assess which of their existing funding arrangements fall within this requirement and so need approval from APRA.

APG 120 paragraph 23 outlines the approach that will be adopted for certain RBA contingent liquidity securitisations.

The current arrangements for the alternative capital treatment for some structures are not expressly covered and so will automatically expire on 1 January 2012. APRA is considering the approach to be adopted for these approvals and will provide direction on how these exposures will be treated in future, closer to 1 January 2012.

**Non-compliance (APS 120 paragraph 23, APG 120 paragraph 29)**

If an ADI does not address all the requirements of APS 120 when they are implemented, APRA has the power to impose quantitative and qualitative limits on the ADI's securitisation activities. As a general principle, APRA would not endorse long-term non-compliance with the requirements of APS 120 without imposing requirements on the ADI to ensure the non-compliance is not perpetuated and that, where possible, is addressed in a timely manner. It is the ADI's responsibility to understand and fully implement the requirements of APS 120 prior to 1 January 2012.