APRA

Response to Submissions

Revisions to the prudential framework for securitisation

November 2016

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Preamble

This paper sets out APRA's response to submissions on the November 2015 Discussion Paper '*Revisions to the prudential framework for securitisation*' (second consultation paper). Accompanying this Response Paper is a final revised *Prudential Standard APS 120 Securitisation* (APS 120), which includes APRA's changes as noted herein. APRA is also consulting on the draft revised *Prudential Practice Guide APG 120 Securitisation* (APG 120).

This Response Paper, final revised APS 120 and draft revised APG 120 are available on APRA's website at: http://www.apra.gov.au.

Written submissions on the draft revised APG 120 should be sent to APS120review@apra.gov.au by 20 December 2016 and addressed to:

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Glossary

Term	Definition
ABCP	Asset-backed commercial paper
ADI	Authorised deposit-taking institution
Advanced ADI	An ADI approved to use the advanced approaches to measuring credit risk for capital adequacy purposes.
APRA	Australian Prudential Regulation Authority
APS 112	*Prudential Standard APS 112 Capital Adequacy: Standardised Approach to Credit Risk*
APS 113	*Prudential Standard APS 113 Capital Adequacy: Internal Ratings-based Approach to Credit Risk*
APS 116	*Prudential Standard APS 116 Capital Adequacy: Market Risk*
APS 120	*Prudential Standard APS 120 Securitisation*
Banking Act	*Banking Act 1959*
Basis swap	An interest rate swap aimed at limiting basis risk in a securitisation. A basis swap includes a payment stream on one leg of the swap based on an observable market rate or index, and a payment stream on the other leg based on rates set by a party to the swap, typically the originating ADI.
Basel Committee	Basel Committee on Banking Supervision
CET1	Common Equity Tier 1 Capital
Credit enhancement	A contractual arrangement in which the ADI or other entity provides some degree of protection against credit losses to other parties holding a securitisation exposure.
Early amortisation	A mechanism in a securitisation of revolving credit facilities that, once triggered, accelerates the reduction of the investor interest in the underlying exposures and allows investors to be paid out, in full or in part, prior to the originally stated maturity of the securities issued.
Implicit support	Support provided by an ADI to a securitisation in excess of its explicit contractual obligations.
Managing ADI	An ADI that manages a securitisation. This may include undertaking responsibility for the day-to-day administration of

Term	Definition
	the SPV, allocation of collections, calculation of payments and preparation of investor reports. A managing ADI may also manage swaps, liquidity and other facilities and events such as the issuance, rollover/refinancing or calling of securities.
Non-senior securitisation exposure	A securitisation exposure that is subordinated to another securitisation exposure.
Originating ADI	With respect to a securitisation, an ADI that directly or indirectly originates underlying exposures in the pool; is the managing ADI for the securitisation; or provides a facility (other than a derivatives transaction) or credit enhancement to an ABCP securitisation.
Pool	The underlying exposure or exposures that are securitised by way of assignment or the transfer of rights and obligations to, or by way of rights and obligations held directly in its name by, an SPV. The pool may consist of, but need not be limited to, loans, bonds or equities.
RBA	Reserve Bank of Australia
Resecuritisation exposure	A securitisation exposure in which at least one of the underlying exposures in the pool is a securitisation exposure.
Securitisation	A financing structure where the cash flow from a pool is used to make payments on obligations to at least two tranches or classes of creditors (typically holders of debt securities), with each tranche or class entitled to receive payments from the pool before or after another class of creditors, thereby reflecting different levels of credit risk.
Securitisation exposure	On-balance sheet and off-balance sheet risk positions held by an ADI arising from a securitisation including, but not limited to, investments in securities issued by an SPV, credit enhancements, liquidity and other funding facilities and derivatives transactions.
Securitisation of revolving credit facilities	A securitisation in which one or more underlying exposures represent, directly or indirectly, current or future draws on a revolving credit facility.
Self-securitisation	A securitisation which is solely for the purpose of using the securities created as collateral in order to obtain funding via a repurchase agreement with the RBA.
Seller interest	A senior or *pari passu* with a senior interest held by an originating ADI of a securitisation of revolving credit facilities,

Term	Definition
	equivalent in size to the total asset pool less the investor interest.
Senior securitisation exposure	A securitisation exposure effectively backed or secured by a first claim on the entire amount of the assets in the underlying pool. Securitisation exposures with different maturities that share *pro rata* loss allocation with senior securitisation exposures so that they benefit from the same level of credit enhancement are themselves senior securitisation exposures.
SPV	A special purpose vehicle that purchases and holds, or otherwise holds directly in its name, the pool for the purpose of a securitisation. The SPV's acquisition of exposures held in the pool is typically funded by debt issued by the SPV, including through the issue of securities or units by the SPV.
Standardised ADI	An ADI that uses the standardised approach to measuring credit risk for capital adequacy purposes.
STC securitisation	Simple, transparent and comparable securitisation
Synthetic securitisation	A securitisation whereby the credit risk, or part of the credit risk, of a pool is transferred to a third party which need not be an SPV. The transfer of credit risk can be undertaken through the use of funded (e.g. credit-linked notes) or unfunded (e.g. credit default swaps) credit derivatives or guarantees.

Executive summary

Securitisation of loans and other assets can be an important and cost-effective mechanism by which an ADI can obtain funding for its business. Australian ADIs have used securitisation successfully for many years to diversify their funding base and make efficient use of capital.

APRA has been working to update its regulatory framework for securitisation to incorporate the most recent internationally agreed regulatory reforms, as well as to reflect the lessons of the global financial crisis and provide a more sustainable basis for the securitisation market going forward.

APRA's main reform initiatives for the securitisation framework are to provide:

- more flexibility for ADIs in their funding arrangements;
- a simpler set of requirements for use of securitisation; and
- simpler approaches to calculating regulatory capital requirements that appropriately reflect risk.

The final revised APS 120 also reflects APRA's implementation of the Basel Committee's revised securitisation framework (Basel III securitisation framework), with appropriate Australian adjustments.

To better reflect underlying risk, and to address the lessons learned from the global financial crisis, APRA's initiatives and the Basel III securitisation reforms include more conservative regulatory capital requirements for some types of securitisation exposures. However, the underlying operational requirements for securitisation are either unchanged or have been simplified.

APRA has responded to issues raised in submissions to refine the final prudential standard. The key issues are detailed in Chapter 2.

In responding to submissions on the revised APS 120, APRA has sought to reach an appropriate balance between the objectives of financial safety and efficiency, competition, contestability and competitive neutrality, whilst promoting financial stability. APRA considers the final revised APS 120 will, on balance, provide improved prudential outcomes and provide efficiency and competitive benefits to ADIs.

The explicit recognition of securitisation for funding purposes in the prudential standard is expected to improve the ability of ADIs to secure long-term, stable wholesale funding.

APRA's reforms to apply simpler approaches to assigning regulatory capital for securitisation exposures will reduce the differential treatment of ADIs using advanced and standardised approaches to regulatory capital for credit risk, which may benefit competition. Further, APRA's clarification of the regulatory capital requirements for warehouse arrangements may also assist smaller ADIs in improving access to term wholesale funding, without creating undue prudential risk.

Timetable

The revised APS 120 will take effect from 1 January 2018. APRA is currently consulting on the draft revised APG 120. In the coming months, APRA will separately consult on revised reporting requirements for securitisation that would take effect at the same time as the revised prudential standard and prudential practice guide.

Chapter 1 — Introduction

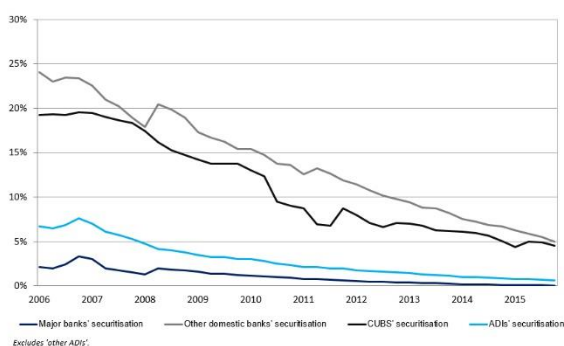
1.1 Background

Securitisation refers to the process whereby loans or receivables are converted into asset-backed securities. The relevant assets are held as a pool in an SPV, which issues securities to investors backed by the cash flows of the asset pool.

Through securitisation, an ADI may borrow at rates determined by the quality of the expected cash flows from the securitised assets, rather than its own credit rating. This enables ADIs with lower credit ratings or limited access to wholesale funding markets to raise funds at more competitive rates. Where the credit risk of the assets is adequately transferred to other parties, ADIs may also receive relief from regulatory capital requirements.

In Australia, securitisation has typically been a material share of funding for a number of ADIs. Smaller ADIs e.g. domestic banks (other than the major banks), credit unions and building societies (CUBS), in particular, use securitisation to generate a greater proportion of funds than larger ADIs. This is represented in the following figure:

Figure 1: Funding composition: Securitisation



The current APS 120 (January 2015) sets out the criteria that ADIs must meet to achieve regulatory capital relief. This prudential standard also includes general requirements applying to an ADI's involvement in all types of securitisation activities and the methodology for calculating an ADI's capital requirement for securitisation exposures.

APRA's objective in revising the prudential framework for securitisation is to establish a simplified framework, taking into account global reform initiatives and the lessons learned from the market disruptions of the global financial crisis. One of the lessons was that securitisation structures had become excessively complex and opaque, while prudential regulation of securitisation had become similarly complex.

APRA first consulted on initiatives to simplify its prudential framework for securitisation in April 2014 with the release of the Discussion Paper '*Simplifying the prudential approach to securitisation*' (first consultation paper). APRA sought feedback on its proposals in its first consultation paper, noting that it intended not to finalise any reforms to its prudential framework for securitisation until, at least, the completion of the Financial System Inquiry and the finalisation of revisions to the Basel Committee's 'Basel II' securitisation framework.[1, 2, 3]

In December 2014, the Basel Committee released its final revisions to its securitisation framework (Basel III securitisation framework). These revisions form part of the Basel Committee's broader Basel III agenda to reform regulatory standards for banks in response to the global

1 The first consultation paper is available at: http://www.apra.gov.au/adi/Documents/securitisation-discussion-paper-april-2014.pdf

2 The final report of the Financial System Inquiry is available at: http://fsi.gov.au/. The Government's response to the Financial System Inquiry is available at: http://www.treasury.gov.au/fsi

3 Basel II securitisation framework: *Basel II – International Convergence of Capital Measurement and Capital Standards: A Revised Framework – Comprehensive version,* June 2006 is available at: http://www.bis.org/publ/bcbs128.htm and Basel II.5 – *Enhancements to the Basel II framework,* July 2009 is available at: http://www.bis.org/publ/bcbs157.htm

financial crisis and thus contribute to a more resilient banking sector.[4]

In November 2015, APRA released a second consultation paper, '*Revisions to the prudential framework for securitisation*' (second consultation paper), which included APRA's response to submissions to its first consultation paper and its proposed implementation of the Basel Committee's Basel III securitisation framework. APRA also released a draft revised APS 120. APRA sought feedback on its proposals in its second consultation paper.[5]

1.2 Final standard

APRA received sixteen submissions to its second consultation paper, of which eight were confidential. In the final version of APS 120, APRA has clarified or amended its proposals in a number of areas following consideration of the issues raised in submissions. The main amendments to the draft revised APS 120 and APRA's clarifications relate to:

- reducing the scope of exposures where a Common Equity Tier 1 Capital (CET1) deduction is required;
- including more flexible arrangements in regard to funding-only securitisations; and
- additional flexibility for ADIs making use of warehouse arrangements that may qualify for regulatory capital relief.

APRA also decided not to modify its proposals in several areas, after considering industry submissions. APRA proposals that remain unchanged include:

- removal of the advanced modelling approaches to calculating regulatory capital requirements;
- treatment of securitisations of revolving credit facilities, ABCP, and synthetic securitisations; and
- the treatment of shared collateral.

Other minor amendments have also been made in response to submissions.

1.3 Transitional arrangements

Transitional arrangements as outlined in the final revised APS 120 will apply. For further discussion on transitional arrangements, see separate section below.

1.4 Prudential practice guide and reporting requirements

In the next few months, APRA intends to release for consultation proposed changes to the prudential reporting requirements for securitisation and covered bonds. These new reporting requirements would take effect at the same time as the final revised APS 120, namely, 1 January 2018. In the interim, APRA is consulting on a draft revised APG 120, which would also take effect from 1 January 2018.

1.5 Simple, transparent and comparable (STC) securitisation

In July 2016, the Basel Committee published an updated standard for the regulatory capital treatment of securitisation exposures that includes the regulatory capital treatment for STC securitisation. This updated Basel standard sets out additional criteria for differentiating the capital treatment of STC securitisation from that of other securitisation transactions.

Given the proposed simplified framework under APS 120, APRA has not seen an immediate need to implement the STC standard. APRA will consider whether there is merit in making further amendments to APS 120 to incorporate STC criteria at a later date.

4 The Basel Committee's Basel III document *Revisions to the Securitisation Framework*, December 2014 is available at: http://www.bis.org/bcbs/publ/d303.pdf

5 The second consultation paper and draft revised APS 120 is available at: http://www.apra.gov.au/adi/PrudentialFramework/Pages/Revisions-to-the-Securitisation-Framework.aspx

1.6 Structure of this paper

Chapter 2 summarises the main issues raised in submissions to APRA's second consultation paper, along with APRA's responses.

Chapter 3 summarises other issues relating to securitisation.

Annexure A provides a comparison of approaches for assigning regulatory capital to securitisation exposures.

Annexure B outlines the regulatory costs of the final revised APS 120.

Chapter 2 — Response to submissions

2.1 Approaches to assigning regulatory capital

2.1.1 Advanced approaches

Consistent with APRA's objective to simplify the securitisation framework, APRA proposed to remove the use of the advanced modelling approaches to determine regulatory capital requirements for securitisation exposures. APRA proposed that all ADIs, including ADIs that use the internal ratings-based approach under *Prudential Standard APS 113 Capital Adequacy: Internal Ratings-based Approach to Credit Risk* (APS 113), would use the external ratings-based approach or the standardised approach (a regulatory formula-based approach) to assign risk weights under APS 120.

Comments received

Submissions commented that the proposed removal of the advanced approaches would significantly increase regulatory capital requirements for securitisation exposures. They submitted that the advanced approaches are risk-sensitive and provide ADIs with the ability to more accurately assess the risks inherent in a securitisation. Submissions commented that APRA's proposal would increase systemic reliance on external ratings and reduce the incentives to improve risk management. Acquiring a rating from a rating agency to use the external ratings-based approach would also add additional surveillance costs.

Submissions argued that the removal of the internal assessment approach would significantly impact warehouse funding facilities, which would either need to be externally rated or restructured with additional credit enhancement levels to minimise the proposed regulatory capital increases. This could lead to inefficient funding structures and increase the cost of funding for ADIs.

APRA response

APRA has evaluated the regulatory capital impact of the different capital approaches under the advanced, external ratings-based and standardised approaches to securitisation for different types of exposures. While there is some increase in capital for certain types of structures under the standardised approach, in light of the minimum 'floor' risk weights imposed under the Basel III securitisation framework, APRA considers the overall impact of not adopting the advanced approaches is not significant (refer to Annexure A for further details).

Risk weight outcomes can clearly vary from transaction to transaction. However, for the most common structures in the Australian market — namely senior residential mortgage-backed securities — it is likely that the Basel III 15 per cent risk weight floor will apply under both the advanced approach and the standardised approach. The external ratings-based approach will result in a slightly higher risk weight than other approaches. For lower levels of credit enhancement (that is, riskier exposures), risk weights are likely to be higher under the standardised approach; this is appropriate given the higher risk of these transactions.[6]

ADIs may use the standardised approach if they do not wish to obtain an external credit rating. As a result, given that capital differences are not large for the most common exposures, and considering the operational burden of maintaining the advanced approaches, APRA has determined not to include the advanced modelling approaches in the securitisation framework.

6 For example, at 3 per cent subordination, the risk weight for a senior Australian residential mortgage-backed security under the standardised approach is likely to migrate to the 35 per cent standardised risk weight of the underlying loans in the pool.

APRA is also extending the risk weight cap for senior exposures, which is discussed further in section 2.4 below.

2.1.2 Simplified risk weights and treatment of sub-investment grade exposures

Under APRA's proposal, most if not all ADIs will use an external ratings-based approach to assign risk weights. APRA proposed to simplify the risk weights under the external ratings-based approach for long-term securitisation exposures by reducing the number of credit rating grades applicable to senior exposures. In addition, all sub-investment grade senior exposures would be required to be deducted from CET1.

Comments received

Some submissions did not support APRA's proposal. Submissions highlighted that a one notch downgrade from investment grade to sub-investment grade has a substantial cliff effect on capital required.

APRA response

Senior exposures comprise approximately 90 per cent of a typical Australian residential mortgage-backed security. Most of these exposures are AAA rated, which reduces the need for more granular risk weights for senior exposures. APRA considers that the significant increase in required capital for sub-investment grade exposures is appropriate given the associated risk.

APRA is also of the view that the determination of risk weights under the Basel III securitisation framework may prove to be relatively complex for some smaller ADIs. To reduce complexity and regulatory burden, all ADIs will have the option to use a look-up table to assign the risk weight for a long term senior exposure commensurate with a 5 year tranche maturity.[7]

2.2 Deduction of non-senior securitisation exposures and resecuritisations

For simplicity and safety, APRA proposed that non-senior securitisation exposures and resecuritisation exposures would be deducted from CET1.

Comments received

Submissions did not support the proposed CET1 deduction for resecuritisation and all non-senior exposures. Submissions remarked that APRA's proposal was not risk sensitive, unnecessarily punitive and inconsistent with the Basel III securitisation framework.

Some submissions requested an amendment to the definition of resecuritisation exposure to include a materiality threshold to ensure minor investments within a securitisation did not result in senior tranches being treated as CET1 deductions.

Submissions commented that the proposed treatment would discourage ADIs from investing in non-senior exposures. Submissions commented that not all non-senior exposures are 'equity-like'; some exposures can be non-senior and not materially exposed to the credit risk of the underlying assets in a securitisation. Some are also repo-eligible.[8]

APRA response

APRA's proposed definition of resecuritisation exposures is consistent with the Basel III securitisation framework. The deduction approach reflects doubts regarding the ability to determine accurate capital charges given the typical complexity and uncertainty over of the quantum and flow of risk.

APRA recognises that deduction of non-senior exposures provides incentives for ADIs to take senior positions. APRA also has an unfavourable

7 To calculate a risk weight for short-term senior exposures, ADIs use a simple look up table to assign the risk weight according to the external credit rating grade. However, the calculation of a risk weight for senior exposures with long-term ratings involves a number of mathematical formulas including linear interpolation of the risk weights in a look-up table and a calculation of tranche maturity (the weighted-average maturity of the contractual cash flows of the tranche or the legal maturity of the tranche).

8 The RBA applies minimum eligibility criteria to purchases of securities under a repurchase agreement (repo).

view of ADIs entering into bilateral or multilateral arrangements to purchase non-senior exposures of other ADI-originated securitisations as this merely shifts credit risk around the banking system.

However, APRA accepts that there may be cases were a deduction approach is overly conservative for low-risk, highly rated non-senior exposures. As a result, APRA has determined that non-senior securitisation exposures that are externally rated at least A3 (short term credit rating) or AA- (long-term credit rating) are not required to be deducted from CET1 and may be risk weighted.

In addition, to reduce complexity and regulatory burden, ADIs will have the option to use a look-up table to assign the highest risk weight for a long term non-senior exposure commensurate with a 5 year tranche maturity.[9]

APRA will allow the use of the standardised approach to assign a risk weight for non-senior securitisation exposures that are unrated or for which the ADI cannot infer a rating. This reflects a more risk-sensitive approach as compared to an outright CET1 deduction.

2.3 Derivatives transactions

APRA proposed that derivatives transactions conducted by an ADI in a securitisation must not be subordinated to any interests of any investor in the securitisation or subject to deferral or waiver; otherwise a CET1 deduction is required.

Comments received

Some submissions commented that derivatives may bear a subordinated position or be subject to deferral or waiver in a securitisation.

APRA response

APRA considers the requirement for seniority of derivatives transactions in a securitisation appropriate. Arrangements where derivatives bear a subordinated position may represent a means by which an ADI could be supporting a securitisation.

2.4 Maximum capital requirements

2.4.1 Risk weight cap for senior exposures

Under Basel III, the maximum risk weight (risk weight cap) for senior exposures is based on the weighted average risk weight of the underlying exposures, as if they had not been securitised. APRA proposed that the risk weight cap for senior exposures may be applied by originating ADIs only.

Comments received

Submissions commented that all ADIs, not just originating ADIs, should be able to apply the risk weight cap for senior exposures. Submissions commented that APRA's proposal would place non-originating ADIs at a competitive disadvantage as investors.

APRA response

APRA has reconsidered this position and will allow ADIs (originators and non-originators) to apply a risk weight cap for senior exposures which are not resecuritisation exposures or are otherwise required to be deducted (for further discussion, see Annexure A).

2.4.2 Maximum capital requirement for the pool as a whole

APRA proposed that a maximum capital requirement, under which an ADI's capital requirement will not exceed the capital requirement for the underlying pool of exposures as if they were all held by the ADI directly, would apply to originating ADIs only.

Comments received

Submissions commented that the maximum capital requirement should apply to all ADIs, regardless of whether they are originator or investor.

9 The calculation of a risk weight for non-senior exposures with long-term ratings involves a number of mathematical formulas including linear interpolation of the risk weights in a look-up table and a calculation of tranche maturity and tranche thickness (the size of the tranche relative to the entire securitisation transaction).

APRA response

APRA considers it appropriate that the maximum capital requirement be applied to originating ADIs only so as not to disincentivise securitisations of low credit risk exposures. For non-originating ADIs, APRA considers that the maximum capital requirement should not apply as it is likely the ADI may hold exposures to the SPV that are required to be deducted from capital.

Further, the Basel III securitisation framework does not allow the maximum capital requirement to be applied for a non-originating ADI under the external ratings-based or standardised approaches. Consistent with this, APRA has not modified its proposal.

2.5 Warehouse arrangements

Securitisation warehouses are financing structures by which an ADI or other entity obtains funding secured by a pool of its loans or other assets. Funding typically is provided on a revolving 12 month basis (known as the availability period).

The regulatory capital treatment of warehouses under APS 120 has long been problematic. Currently, it is possible for warehoused assets to create capital arbitrage opportunities — ADI originators can treat the loans as 'sold' with no capital requirements, while the warehouse funder, which may be an ADI using the internal ratings-based approach, can risk weight the senior exposure as low as 7 per cent. This results in capital 'leakage' from the banking system despite no change in overall risk. Providing capital relief for a long-term asset such as a residential mortgage via a short-term warehouse funding vehicle is also potentially fraught with inherent conflict as it could lead to the provision of implicit or explicit support by ADI originators to the warehouse.

To address these concerns, APRA proposed that the focus in the draft revised APS 120 be on whether capital relief is applicable for the originating ADI, including significant credit risk transfer and permanency of funding. Funding would need to be in place for the life of the underlying pool so that securities issued by the SPV will be sufficient to fund the exposures in the pool up to their longest contractual maturity date. Under the draft revised APS 120, a 15 per cent risk weight floor would apply to the senior exposure held by the warehouse provider.

Under APRA's proposal, warehouses would not obtain capital relief if they were not match-funded. Structures with revolving funding periods that provide for any renegotiation of terms and conditions (including funding rates) of the warehouse funding line would generally not meet these capital relief requirements.

Comments received

Several submissions sought clarification with regards to permanency of funding as a pre-condition for capital relief; whether an originating ADI could renegotiate the terms and conditions (including funding rates) of the warehouse funding line to extend an availability period and whether this precluded the originating ADI from being able to achieve capital relief.

Some submissions requested that warehouse providers should be able to use the advanced approaches to determine regulatory capital requirements so that capital costs associated with warehouse facilities would be less than alternative approaches. For particular discussion on the advanced approaches, see separate section above.

APRA response

Under the final revised APS 120, warehouses will not obtain capital relief if they are not match-funded. However, APRA has clarified in the draft revised APG 120 that warehouses with availability periods may qualify for capital relief provided the renegotiation of terms and conditions of the warehouse funding line relates to funding rates only and that these rates reflect prevailing market rates. A predetermined step-up margin may apply, as long as it is not funded by the originating ADI. No other changes must be made to the terms and conditions of the securitisation upon renewal of the availability period. APRA believes that this will

facilitate the continued use of warehouses for capital-relief purposes in many instances.

2.6 Funding-only securitisation

2.6.1 Two credit classes

A funding-only securitisation is where the originating ADI issues securitisation for funding but does not seek regulatory capital relief for the underlying assets in the pool. In a funding-only securitisation, the originating ADI generally retains most of the credit risk and holds regulatory capital for the securitised assets as if the securitisation has not occurred. APRA proposed that a funding-only securitisation could have only two credit classes, whereby an originating ADI could hold some or all of the non-senior securities and sell the senior securities to obtain funding.

Comments received

Submissions requested that funding-only securitisation be permitted to include more than one class of non-senior securities on the basis that this would not add additional complexity and could potentially provide an ADI with additional funding. Some submissions were concerned that two credit classes limited the ability for ADIs to respond to market conditions or utilise securitisation as a capital management tool.

APRA response

The final revised APS 120 allows more than one class of non-senior securities in a funding-only securitisation, provided the securitisation does not feature a date-based call option (for particular discussion on date-based call options see separate section below). In these circumstances, an ADI may transition a funding-only structure to a capital relief securitisation by selling sufficient non-senior securities. Where a securitisation includes a date-based call option, the securitisation would have to be structured as a funding-only securitisation with two credit classes only.

2.6.2 Date-based call options

Some securitisations in the market are structured with one or more bullet securities with a fixed (or expected) maturity date prior to the final legal maturity. Under APS 120, so-called 'hard bullets', which must be paid in full on maturity, must not be funded by the originating ADI. An originating ADI may fund a soft bullet by exercising a date-based call option. In the draft revised APS 120, APRA proposed that date-based call options be allowed in funding-only securitisations.[10, 11]

Comments received

Some submissions sought clarification whether a step-up margin on the securities was permitted if the originating ADI did not exercise a date-based call.

APRA response

The draft revised APG 120 clarifies that a step-up margin may apply, as long as it is not funded by the originating ADI, including through a basis swap.

2.6.3 Securitisation of revolving credit facilities

In the draft revised APS 120, APRA proposed that securitisations of revolving exposures (such as credit cards) must be treated as funding-only. The submissions on this topic mostly related to various technical aspects, including amortisation events and first loss and other credit enhancements.

Comments received

Submissions sought clarification on how originating ADIs address the ongoing funding requirement for revolving assets in securitisation upon an amortisation event. Submissions noted that, in this case, the ADI is contractually bound to fund future draws on credit cards that are not in default. Some submissions requested that the amortisation

10 Hard bullets involve a contractual obligation to repay an amount on a given date.

11 Soft bullets involve an option but not an obligation on the part of the ADI issuer to repay a given debt tranche or class on a given date.

requirements should not apply to scheduled amortisation.[12, 13]

APRA response

Under the final revised APS 120, any amortisation event (whether early or scheduled) must end the ability of the originating ADI to add new exposures to the securitisation (i.e. further draws even if from the same underlying borrower). To avoid its interests being subordinated to those of investors, or cash flows being streamed to investors who have not provided funding, an originating ADI must fund further draws after an amortisation event outside of the securitisation.

2.6.4 ABCP securitisation

In the draft revised APS 120, APRA proposed that an originating ADI of an ABCP securitisation must treat the securitisation as funding-only.

Comments received

One submission commented that APRA's proposal would mean that regulatory capital allocated to support funding through an ABCP securitisation would represent many multiples of that required for a self-funded portfolio.

Two submissions sought clarification whether an ABCP conduit itself was considered a securitisation if cash flows from the pool(s) are used to make payments to only one class of creditors.

APRA response

APRA's long-standing definition of originating ADI captures an ADI that provides a liquidity facility (or a credit enhancement) to an ABCP securitisation. This definition is consistent with the Basel III securitisation framework.

APRA considers it appropriate that an ADI liquidity provider to an ABCP securitisation hold capital for the whole pool as liquidity providers can be exposed to credit risk arising from their links with ABCP.

APRA's approach may result in some structures having two or more ADIs considered as originating ADIs and with each ADI holding capital for the whole pool. In these circumstances, the ADI providing the liquidity facility or credit enhancement need not hold additional capital for the facility.

APRA has clarified in the draft revised APG 120 that an ABCP conduit would need to be assessed on a case by case basis to determine whether it is a securitisation or resecuritisation. In considering whether an ABCP conduit is a securitisation, an ADI would be expected to look at the economic effect of the whole structure, rather than focus on the status of each SPV in the structure on a stand-alone basis.

2.6.5 Self-securitisation

In the draft revised APS 120, APRA proposed that self-securitisations must be structured in the same manner as funding-only securitisations. An ADI that undertakes a self-securitisation must comply with the funding-only requirements from the point it uses the securities as collateral to obtain funding under a repurchase agreement (repo) from the central bank. Until a repo is entered into, the self-securitisation is not a securitisation for the purposes of APS 120.

Comments received

Submissions commented that ADIs should have the flexibility to buy back loans, redeem notes and sell additional loans at any time within a self-securitisation to comply with the RBA's required criteria.

APRA response

Self-securitisation is a special form of funding-only securitisation. In the final revised APS 120, APRA

12 An amortisation event is a mechanism in a securitisation of revolving credit facilities that, once triggered, accelerates the reduction of the investor interest in the underlying exposures and allows investors to be paid out, in full or in part, prior to the originally stated maturity of the securities issued.

13 In regard to scheduled amortisation, it is agreed at the outset the date upon which principal repayments will be made whereas under early amortisation, the principal repayment of the securities is accelerated as a result of certain trigger events occurring.

has confined self-securitisation to those that are only for the purposes of repo with the RBA. APRA has provided some exemptions for self-securitisation which are designed to avoid conflict between an ADI meeting provisions required of funding-only securitisation under the final revised APS 120 and the eligibility requirements set by the RBA for use of securitised assets in repos. Such exemptions are restricted to meeting RBA eligibility requirements and do not apply where the securities involved are held by other parties.

2.7 Synthetic securitisation

In the draft revised APS 120, APRA proposed that an originating ADI would not be able to recognise any capital relief in a synthetic securitisation.

Comments received

Submissions highlighted the use of synthetic securitisation as a risk management tool for hedging assets held in the banking book.

Submissions noted that it may be challenging to transfer some portfolios for legal, relationship and operational reasons, and therefore risk transfer could only be transferred synthetically in these cases.

APRA response

Synthetic securitisation is not a significant feature of the Australian market. These structures tend to be opaque and the true extent of credit risk transfer is not always clear until a period of stress occurs. APRA considers recognition of any capital benefits for synthetic securitisation would be counter to its objective to simplify the securitisation framework.

2.8 Shared collateral and trust-back arrangements

Trust-back arrangements are a specific feature in some securitisation arrangements that enable an ADI to maintain a security interest where it holds a loan for which the underlying collateral (e.g. a securitised housing loan) has been assigned to an SPV.

APRA's current policy is long-standing and provides that loans subject to trust-back arrangements are not eligible for a risk weight of less than 100 per cent, unless a formal second mortgage is in place.

Comments received

Submissions commented that trust-back arrangements provide an ADI with the equivalent rights, rankings and cash flows as a registered second mortgage, including following a title perfection event. Submissions commented that trust-back arrangements were operationally efficient and enabled ADIs to avoid the time, costs and logistical issues associated with registering a second mortgage.

APRA response

There is considerable uncertainty as to how trust-back arrangements would be interpreted in a commercial dispute, especially in a crisis situation.

For these reasons, APRA considers its current policy appropriate. ADIs may choose to operate trust-back arrangements to address any administrative and logistical issues; however, these will not be recognised for capital risk weighting purposes.

2.9 Other issues from submissions

2.9.1 Definition of securitisation

In the draft revised APS 120, APRA replicated the Basel III securitisation framework, which clarified that a securitisation structure was different to an ordinary senior/subordinated debt structure. Further (and also consistent with the Basel III securitisation framework), the draft revised APS 120 noted that a securitisation pool 'may consist of, but need not be limited to, loans, bonds or equities'.

Comments received

One submission suggested the definition of securitisation should be limited to structures where all or substantially all of the underlying exposures are financial exposures.

One other submission requested the definition of securitisation to contemplate structures where the assets are originated in the name of the SPV as opposed to being acquired from a seller.

APRA response

In the final revised APS 120, it is made clear that the list of underlying instruments in the pool being securitised is not an exhaustive list. Limiting the definition to all or substantially all of the underlying exposures being financial exposures may have unintended consequences and therefore is not appropriate.

APRA has amended the definitions of 'pool', 'SPV' and 'traditional securitisation' so that the final revised APS 120 recognises that for some securitisation transactions, the relevant assets may be originated directly in the name of the SPV.

2.9.2 Definition of originating ADI

In the draft revised APS 120, APRA's definition of originating ADI is broader than that of the Basel III securitisation framework as it includes all managing ADIs.

Comments received

Some submissions suggested excluding managing ADIs from the definition of originating ADI. These submissions commented that some provisions in the draft revised APS 120 were not relevant to managing ADIs.

APRA response

APRA's approach, which is long-standing policy, is that the definition of an originating ADI should capture a managing ADI, as a managing ADI has a close association with a securitisation that would be known in the marketplace. For this reason, APRA considers it appropriate that a managing ADI be subject to the same requirements as an originating ADI, including the prohibition on implicit support.

2.9.3 Prior notification

In the draft revised APS 120, APRA proposed a prior notification requirement for secured funding arrangements that are not securitisations under APS 120, subject to certain exceptions.

Comments received

One submission queried why the exception from prior notification for repos was limited to repos over marketable (publicly rated, tradeable) securities and submitted that all repos should be included in this exception. The same submission requested that prior notification should only apply to the ADI itself, and not to arrangements which involve Level 2 entities.

Another submission sought clarification on whether the prior notification requirements only apply to an interest in an ADI's Australian assets.

APRA response

APRA considers it appropriate that prior notification be required for repos that are not publically rated, tradable securities. Such repos could be highly structured securities and haircuts on the value of the securities could be much higher (with consequent larger amounts of overcollateralisation involved). The exception for marketable (publically rated, tradeable) securities is to recognise that these repos may form part of an ADI's daily liquidity management practices.

The prior notification requirements apply to the ADI at Level 1 and Level 2. APRA has clarified in the final revised APS 120 that the exception from prior notification includes an overseas Level 2 banking subsidiary that issues covered bonds in line with the rules of the relevant host regulator.

Chapter 3 — Other issues

3.1 Transitional arrangements

APRA proposed a 1 January 2018 implementation date for the revised APS 120, consistent with the Basel III securitisation framework. The Basel III securitisation framework does not provide for any transitional arrangements for those changes. However, APRA is providing transitional arrangements for certain aspects that are not part of the Basel III measures.

In meeting the revised requirements in Attachment D of the final revised APS 120, ADIs may need to seek investor approval to change the documentation. While not specifically raised in submissions, APRA will provide transitional arrangements for existing facilities agreements in regard to Attachment D of the final revised APS 120. However, there is no transition relief in respect of the capital requirements.

Existing facilities agreements provided by an ADI that comply with the current APS 120 (January 2015) will be eligible for transitional arrangements to the earlier of the termination of the agreement or the first date the agreement may be renewed or cancelled at the option of the parties.

For avoidance of doubt, APRA has noted in the final revised APS 120 that exposures to securitisation SPVs are subject to the new capital requirements from 1 January 2018.

In relation to capital relief for the underlying pool of exposures, ADIs will be able to continue the current treatment for existing securitisation structures under the current APS 120 (January 2015) until these structures are wound up via a clean-up call. In the absence of a clean-up call for these existing transactions, the originating ADI may apply, and APRA may agree, to alternate transitional arrangements.

3.2 Previous exercise of discretion

APRA has included a provision in the final revised APS 120 that will require an ADI to contact APRA should the ADI intend to place reliance on a previous exemption or other exercise of discretion by APRA under a previous version of APS 120. APRA will assess whether an ADI is able to continue to place reliance on a previous exemption or exercise of discretion. This is intended to prevent ADIs from relying on indefinite exemptions or approvals that may no longer be appropriate.

3.3 Consequential changes to other prudential standards

In its second consultation paper, APRA proposed consequential changes to other prudential standards to support implementation of the revised APS 120.

These consequential changes included changes to APS 116 to reflect the proposal that securitisation exposures held in the trading book would be deducted from CET1 if those exposures were required to be deducted if held in the banking book, as well as to reflect the removal of advanced modelling approaches.

APRA intends to review APS 116 more broadly as a result of the Basel Committee's revised minimum capital requirements for market risk released in January 2016. Therefore APRA does not propose to make consequential changes to APS 116 relating to the final revised APS 120 until the outcome of APRA's broad review of the trading book requirements is complete.[14]

Nonetheless, it is APRA's expectation that ADIs will, from 1 January 2018, apply a deduction approach to those securitisation exposures held in the trading book if those exposures were required to be deducted if held in the banking book. Similarly, ADIs would also be expected to apply the

14 Refer to Basel Document *Minimum capital requirements for market risk*, January 2016 at: http://www.bis.org/press/p160114.htm

standard method for interest rate specific risk for securitisation exposures held in the trading book.

Annexure A — Comparison of approaches to assigning regulatory capital

As with any other credit exposure, ADIs are exposed to credit risk from the securitisation exposures they hold. For this reason, ADIs are required to hold regulatory capital for securitisation exposures according to their risk.

There are a range of approaches to assigning regulatory capital under the Basel III securitisation framework; namely the internal ratings-based, external ratings-based and standardised approaches. The external ratings-based approach relies wholly on public credit ratings, while the internal ratings-based approach is a modelled approach based on the features of each securitisation exposure. The standardised approach is based on a regulatory formula.

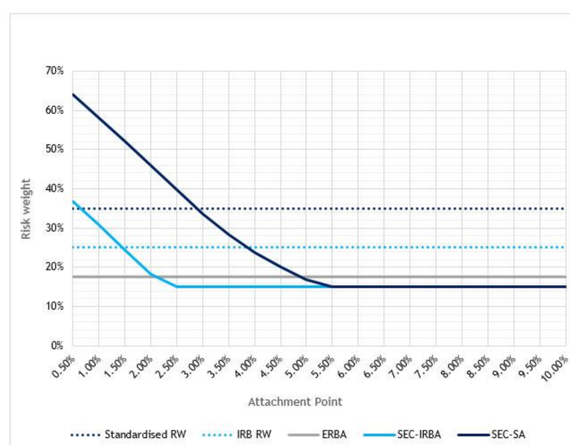
The Basel III securitisation framework introduces a minimum or 'floor' risk weight for all securitisation exposures of 15 per cent. The application of this floor will result in higher risk weights (and thus higher capital requirements) than is currently the case for all highly rated securitisation exposures held by ADIs.

Typically, Australian residential mortgage-backed securities are structured to provide a level of credit enhancement sufficient for the senior notes to obtain a AAA credit rating. Since 2013, the senior notes in ADI-issued residential mortgage-backed securities have had at issuance around 8 per cent credit enhancement from non-senior notes (an attachment point of 8 per cent).[15] For a senior residential mortgage-backed security, the 15 per cent risk weight floor would likely apply under the internal ratings-based approach (described as SEC-IRBA in the figure below) and the standardised approach (described as SEC-SA in the figure below), whereas the external ratings-based approach may produce a slightly higher risk weight.[16]

At lower levels of subordination, risk weights are likely to be higher under the standardised approach compared to the internal and external ratings-based approaches.

This is represented in the following figure:

Figure 2: Approaches to assigning regulatory capital for a senior Australian RMBS



As detailed in Figure 2, regulatory capital would not differ materially under each of the Basel III securitisation approaches for common Australian senior exposures. However, required capital will be higher than under the current APS 120 (January 2015) for ADIs using both the current standardised and advanced modelling approaches.

As noted above, APRA will also allow a risk weight cap for those senior exposures (which are not resecuritisation exposures or are otherwise required to be deducted) that are held by all ADIs, not just originating ADIs. As detailed in the final revised APS 120, an originating ADI may apply the maximum risk weight (risk weight cap) for senior exposures based on the weighted average risk weight of the underlying exposures under *Prudential Standard APS 112 Capital Adequacy:*

15 The attachment point of a tranche is the minimum loss on the underlying pool that affects the tranche.

16 Assuming: a 35 per cent risk weight under the standardised approach in APS 112; a 25 per cent correlation factor under the internal ratings-based approach in APS 113; a loan-to-valuation ratio (LVR) > 70% ≤ 80%; a 3 year maturity for the senior tranche; 0 delinquency and a AAA external rating for the senior tranche.

Standardised Approach to Credit Risk (APS 112) (described as the Standardised RW in the figure above) or APS 113 (described as the IRB RW in the figure above), where appropriate. Where an ADI is not the originator, it may apply the risk weight cap based on the weighted average risk weight of the underlying exposures under APS 112 only.

Annexure B — Regulatory costs

This annexure formalises and documents the steps taken in finalising the revised APS 120.

In its first two consultation papers, APRA outlined the problem in regard to securitisation, the prudential regulation of securitisation and why regulatory initiatives were needed.[17]

APRA's first consultation paper was an exploratory paper.

Following the feedback received, APRA further engaged extensively with industry to conduct further consultation. APRA released a second consultation paper and a draft revised APS 120 for comment. This second consultation paper also included APRA's proposed implementation of the Basel III securitisation framework.

Policy options to address the problem in regard to securitisation and the likely net benefit of each option were outlined in APRA's second consultation paper. APRA identified three options to address the issues identified.[18]

These three options were as follows:

- the first option was to maintain the *status quo* under which no changes would be made to APS 120 and associated reporting standards and forms;
- the second option was for APS 120 and associated reporting standards and forms to be amended to simplify the framework, in consideration of submissions received, but without incorporating the Basel III securitisation framework; and
- the third option was to include in APS 120 both APRA-initiated proposals and the Basel III securitisation framework (with appropriate Australian adjustments), in consideration of submissions received. APRA noted that the third option, if chosen, would be achieved by amendments to APS 120 and associated reporting standards and forms.

The only material difference between the second and third options is the update to the prudential standard to align with the Basel III securitisation framework.

Assessment of regulatory costs

APRA specifically invited submissions on any increases or decreases to regulatory costs incurred as a result of each option. Respondents were invited to use the Australian Government's Burden Measurement Tool to assess regulatory costs. None of the submissions took up the invitation to use this tool.[19]

APRA has considered all relevant compliance costs (e.g. administration and substantive compliance costs and delay costs) in estimating the regulatory cost of each option. This includes the costs of complying with revised capital requirements i.e. the capital compliance costs primarily relate to performing an alternative capital calculation. Regulatory costs have been estimated with regard to APRA's understanding of the average number of staff involved in an ADI's compliance area specific to securitisation and the cost of staff, including specialist legal staff.

It is important to note that not all ADIs undertake securitisation activity and those ADIs which participate in securitisation may have different roles within a securitisation. For the purpose of the Burden Measurement Tool, APRA has taken a conservative approach and assumed all ADI participants in securitisation take on all types of roles. In practice, APRA would expect that ADIs

17 Refer to the first consultation paper (Chapter 1 Introduction on pages 10-13) and the second consultation paper (Chapter 1 Introduction on pages 10-15 and Chapter 3 Implementing the Basel III securitisation framework on pages 26-29).

18 Refer to the second consultation paper (Annexure: Policy options and comparative net benefits on pages 31–34).

19 This tool calculates the compliance costs of regulatory proposals on business, individuals and community organisations using an activity-based costing methodology. The tool is designed to capture the relevant costs in a structured way, including a separate assessment of upfront costs and ongoing costs. It is available at: https://rbm.obpr.gov.au/home.aspx

that only have a limited role, e.g. as an investor or facility provider to a securitisation, would have a lower proportion of the estimated costs.

The consideration of regulatory costs as reflected in the average annual regulatory costs relates to additional compliance costs and does not include capital costs. APRA has considered the capital costs of each of the options separately.

The first option

Compliance cost

Under the first option, ADIs and other stakeholders would not incur any additional compliance costs (Table 1 below).

Table 1 - Average annual regulatory costs (first option)				
Change in costs ($ million)	Business	Community organisations	Individuals	Total change in costs
Total by sector	$0	$0	$0	$0

Regulatory capital cost

Under the first option, ADIs would not incur any additional capital costs.

The second option

Compliance cost

Under the second option, it is likely ADIs would incur additional compliance costs (Table 2 below).

Table 2 - Average annual regulatory costs (second option)				
Change in costs ($ million)	Business	Community organisations	Individuals	Total change in costs
Total by sector	$4.583	$0	$0	$4.583

As noted above, none of the submissions took up the opportunity to use the Burden Measurement Tool. However, one submission indicated the items set out in the tool are estimated to be relatively small.

The current APS 120 (January 2015) requires an ADI to assess, in writing, each securitisation in which it participates and the assessment must demonstrate compliance with the prudential standard. For the second option, APRA is not proposing any change to this requirement.

The additional compliance costs under the second option involve a one-off update to an ADI's self-assessment processes and policies to reflect any revisions to the prudential standard.[20] The prudential standard does not prescribe the most appropriate format for the self-assessment and therefore each ADI is free to determine the most appropriate format.

APRA is proposing transitional arrangements for existing securitisation transactions; ADIs will not be required to revisit these individual self-assessments. For new securitisations, ADIs will be required to conduct a self-assessment, but apart from the one-off update to an ADI's processes and policies, APRA estimates there will be no additional on-going compliance costs for new securitisation transactions.

Compliance costs also include those associated with prudential reporting requirements. ADIs are currently required to report their securitisation activities to APRA and are required to calculate

20 The figure in Table 2 represents the one-off implementation costs and not the average annual ongoing costs, as APRA estimates that no additional annual ongoing costs would accrue.

regulatory capital requirements. In regard to the second option, APRA is proposing to streamline the prudential reporting requirements so that the volume and detail of reporting is reduced. The additional cost under the second option involves a one-off update to reporting forms which will require some system changes. APRA considers each ADI would have the existing data to complete updated reporting forms and that any system changes would be immaterial in regard to existing infrastructure.

Under the second option, ADIs will also need to revise their methodologies for calculating regulatory capital requirements. APRA does not expect that the calculation of regulatory capital requirements is materially more complex than under the current prudential standard, and in some cases will be simplified. Overall, APRA considers the costs of complying with the regulatory capital requirements as being comparable to the current costs of complying (i.e. the calculation under the second option is not any more burdensome than the first option).

APRA considers there are no delay costs in relation to the second option (e.g. expenses and loss of income incurred by an ADI through an application delay or an approval delay) as there is no requirement for an application or approval to undertake a securitisation under the second option.

Under the second option, APRA envisages a start date of 1 January 2018 for the introduction of the reforms. APRA consider there is sufficient notice of proposed prudential and reporting requirements to allow ADIs to undertake any necessary changes to self-assessment and reporting processes. Given the quantum of compliance costs, APRA considers it likely that they will be easily absorbed by business and not passed on to consumers.

Regulatory capital cost

For ADIs with securitisation exposures, there are likely to be additional capital costs under the second option.

Clearly capital costs can vary from transaction to transaction; however, (aggregate) capital costs for the most common structures such as typical Australian residential mortgage-backed securities are estimated to be higher than under the first option, depending on whether the ADI is an Advanced ADI or Standardised ADI (refer to Table 4). For Advanced ADIs in particular, risk weights for AAA-rated structures would rise from 7-12 per cent to 20 per cent. The impact on Standardised ADIs would be much less.[21]

The introduction of funding-only securitisation under the second option does not impose additional capital costs for originating ADIs. In addition, APRA initiatives to treat complex securitisation i.e. synthetic securitisation, ABCP securitisation and securitisation of revolving credit facilities as funding-only securitisation are not considered material as these types of securitisations are not a large feature of the Australian market.

ADIs are likely to achieve cost savings from funding-only securitisation, including a reduction in funding costs with the ability to issue 'soft bullet' securities; the extent of this price benefit for ADIs is difficult to determine, but some industry estimates indicate a cost saving for residential home loans of up to 0.05 per cent for Australian dollar issuance and up to 0.30 per cent for foreign currency issuance.[22]

In relation to funding-only securitisation, the industry has indicated possible further annual cost savings for each ADI issuer of between $500,000 to $1.0 million by way of reduced establishment and operational costs including savings in legal costs, rating agency fees and trustee fees. Additionally, industry has indicated cost savings for each ADI

21 For senior notes, assume 8 per cent credit enhancement from subordinated notes, compared with around 3 per cent for mezzanine notes.

22 Industry submissions have argued that funding-only securitisation promotes greater secondary market transparency and liquidity as investors attain greater confidence of maturity of the securities issued. Funding-only securitisation may also reduce the cost of foreign currency issuance because the hedging profile of foreign currency cash flows is known with greater certainty.

issuer of approximately $300,000 to $500,000 per annum as a result of the managing ADI needing to report to investors on one trust as opposed to multiple trusts.[23]

A simplified prudential framework is likely to support growth in the volume of securitisation, particularly offshore issuance. This is likely to make securitisation a more attractive funding option for ADIs. However, under this option, non-compliance with the Basel III securitisation framework could act as a counterweight to any significant growth in the volume of securitisation, particularly offshore issuance. Overseas investors could be less likely to invest in ADI-issued securitisation if the Australian prudential framework was not internationally compliant.

The third option

Compliance cost

Under the third option, ADIs would likely incur additional compliance costs (Table 3 below).

Table 3 - Average annual regulatory costs (third option)				
Change in costs ($ million)	Business	Community organisations	Individuals	Total change in costs
Total by sector	$4.583	$0	$0	$4.583

The third option is likely to have similar compliance costs as the second option.

Regulatory capital cost

For ADIs with exposures to securitisation SPVs, there are likely to be additional capital costs. Capital costs can vary from transaction to transaction; however, aggregate capital costs for typical Australian residential mortgage-backed securities are estimated to be somewhat higher than the first and second options, reflective of the the revised Basel III securitisation risk weights. (Refer to Table 4).

The benefits of these higher capital requirements under the third option are that it addresses risks highlighted by the global financial crisis of insufficient capital for certain exposures. Additional risk drivers such as maturity of a securitisation's tranche, address weaknesses in the current framework, which resulted in under-capitalisation of certain exposures.

Under the third option, ADIs would be able to use the standardised approach (a supervisory formula approach) under the Basel III securitisation framework to assign risk weights, in the absence of external ratings. While there is some increase in capital for certain types of structures under the standardised approach, in light of the minimum ‘floor’ risk weights imposed under the Basel III securitisation framework, APRA believes the overall impact of not adopting the advanced approaches is not significant for the most common structures.[24]

Similar to the second option, there are no additional capital costs for originating ADIs in regard to funding-only securitisation. Commercially, ADIs would achieve cost savings from funding-only securitisation similar to that of the second option. Implementing the Basel III securitisation framework would assist growth in the volume of securitisation, particularly offshore issuance. Overseas investors would be more likely to invest in ADI-issued securitisation knowing that the Australian prudential framework was internationally compliant. In this regard, the third option is likely to be more beneficial for ADIs than the second option.

23 Industry has commented that funding-only securitisation (with date-based call options) can be significantly more efficient from a timing and logistical perspective. Because it allows for programmatic issuance rather than specific bespoke issuance, funding-only securitisation can reduce documentation, rating agency and other internal costs materially for new issues. Importantly, funding-only securitisation can facilitate speedier execution of new issuance.

24 The objective of the Basel III securitisation floor risk weight is to ensure that the level of capital across the banking system does not fall below a certain level. This also enhances the comparability of capital outcomes across banks.

Table 4 - Capital costs (first, second and third options)			
Exposure	Risk weight (first option)	Risk weight (second option)	Risk weight (third option)
AAA (senior)	20%* (7%**)	20%	15%-20%+
AAA (non-senior)	20%* (12%**)	20%	15%-70%+
AA (non-senior)	20%* (15%**)	20%	30%-120%+
A (non-senior)	50%* (20%**)	CET1 deduction	CET1 deduction
BBB (non-senior)	100%* (75%**)	CET1 deduction	CET1 deduction
Unrated (non-senior)	1250%	CET1 deduction	CET1 deduction

*using the external ratings-based approach under the current APS 120 (January 2015)
**using the advanced approaches under the current APS 120 (January 2015)
+using the external ratings-based approach under the Basel III securitisation framework

Conclusion

Under the first option, there would be no additional compliance and regulatory capital costs. However, the securitisation framework would remain relatively complex and not internationally compliant.

In regard to the second and third options, compliance costs and regulatory capital costs are estimated to increase. Commercially, some savings may be achieved by ADIs that issue funding-only securitisation.

APRA considers there is no material difference in compliance costs for the second and third options. However, APRA considers the third option the best option from those considered as it adopts the Basel III securitisation framework, with appropriate Australian adjustments, and provides for a simplified framework. This best addresses the objective that the prudential framework for securitisation should be simpler and easier for stakeholders to understand, and is internationally compliant. Refer to Table 5.

Table 5 - Summary of the net benefits of each option			
	First option	Second option	Third option
Compliance cost	No change	Low to moderate cost	Low to moderate cost
Regulatory capital cost	No change	Low to moderate cost	Moderate cost
Compliance with G20 agreements and Basel III framework	Does not meet this criteria	Does not meet this criteria	Meets this criteria
Overall	High net cost	Moderate net cost	Low to moderate net cost

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