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Mr Bernie Egan  
Basel II Program Director  
Australian Prudential Regulation Authority  
GPO Box 9836  
SYDNEY NSW 2001

Ms Katrina Squires  
Senior Specialist Basel II  
Policy Research and Statistics  
Australian Prudential Regulation Authority  
GPO Box 9836  
SYDNEY NSW 2001

By Email: [basel2@apra.gov.au](mailto:basel2@apra.gov.au)

Dear Mr Egan and Ms Squires,

### **Response to draft APS 120 – Securitisation**

Thank you for the opportunity to provide written submissions on APRA's draft APS 120 – Securitisation and in particular, for extending the time period within which the Australian Securitisation Forum ("ASF") may lodge its submission.

The ASF is pleased to provide you with this submission, which reflects the views of representatives from all areas of the securitisation industry, including ADIs, law firms, accountants and auditors and independent consultants.

As you would be aware, securitisation plays a very important role in the Australian financial markets. Through securitisation, ADIs have been able to fund assets off balance sheet, often at cheaper margins than "on balance sheet funding". Further, the use of securitisation techniques has enabled ADIs to increase the size of their loan books, without relying on shareholder and depositor funds. Equally, securitisation techniques have enabled non ADIs and "non balance sheet" lenders who would not otherwise be able to participate in the provision of financial services, to obtain wholesale funding through the capital markets at competitive margins and to set up businesses along side ADIs. All this has resulted in increased competition in the Australian financial markets, a wider range of products and lower margins for borrowers. Finally, the securitisation market has created an important source of revenue to ADIs, through the provision of warehousing facilities, derivatives, liquidity and other funding facilities, and arrangement, dealing and underwriting services to securitisation vehicles.

The Australian domestic securitisation market is a well developed, sophisticated market that has been in existence for around 20 years. During that period domestic ADIs have played a major role.

Also during the period that the Australian securitisation market has developed, APRA, the ADIs and the industry in general have sought to collaborate on issues pertaining to prudential regulation of the industry. In the spirit of collaboration, the ASF is keen to explore avenues for more regular and open communication and the sharing of insights on securitisation matters. To that end, the ASF proposes for APRA's consideration the following initiatives (based on current practices of the United Kingdom, Financial Services Authority ("FSA")):

- regular bi-monthly meetings between representatives of APRA and any ADI that wishes to attend. The meetings would have a formal, pre-agreed agenda, based on securitisation topics nominated by APRA and/ or any ADI;
- an APRA database, publicly accessible through the APRA website, where minutes of the above meetings are published, together with any papers published by APRA or submissions or written responses by APRA on questions/ topics relating to securitisation.

The ASF believes that the above will be beneficial to APRA (in terms of providing timely and detailed information about the market, new trends and structures) and to ADIs (in terms of clarifying APRA's views on certain securitisation practices and how they will be treated). Most importantly, the ASF believes that greater communication through these channels will lead to greater certainty.

### **The ASF Submission**

The ASF has prepared and attached as Annexure A, a copy of APRA's draft APS 120 with the ASF's individual comments inserted below the relevant paragraphs. In some instances, the ASF has prepared proposed drafting changes and has marked up those changes within the relevant paragraph. An explanatory note detailing the ASF's rationale for each of those changes (other than where the change is self explanatory or to correct typographical errors) appears below the relevant paragraph. In other instances, rather than preparing proposed drafting changes, the ASF has included a drafting note setting out the ASF's concerns and issues with the relevant concept or principle. The ASF has adopted this approach in these instances because the issue raised may have broader implications for the prudential standard.

In addition to the specific comments in Annexure A, the ASF makes the following comments:

- **Commencement of New APS 120**

In the Discussion Paper accompanying draft APS 120, APRA states that it expects any new or modified securitisations that are undertaken subsequent to the release of the draft will be broadly in line with the new proposed requirements. This suggests that APRA is expecting some or all of the draft to take immediate effect.

Until the new Prudential Standard is in final form, its requirements will not be settled. Accordingly, as the final requirements will not be known it is not feasible that ADIs should be expected to comply with APS 120 while still in draft form. In addition, significant elements of the new APS 120 are linked to the Basel II standards that commence on 1 January 2008 (see for example Attachments B & C). The ASF does not believe that it is practical for parts of APS 120 to apply immediately and for the implementation of other sections to be delayed until 1 January 2008. Such a proposal could cause ADIs to incur significant costs in modifying existing arrangements and

documentation to comply with the draft APS 120, which may prove to be unnecessary, because the final APS 120 does not ultimately require these modifications or requires them to be addressed in a different manner. Also, such a proposal involves a degree of uncertainty unless APRA specifically indicates the provisions of the new APS 120 it expects immediate compliance by ADIs.

As an alternative, the ASF recommends that the new APS 120 commence on 1 January 2008 in its entirety. This is consistent with the start date for the other Prudential Standards implementing the Basel II Framework Agreement. Given the likely time frame for settling the new APS 120 in the early part of 2007, such a start date will provide a reasonable lead time after the final APS 120 has been published for ADIs to modify their existing arrangements and documentation in anticipation that all new securitisations after 1 January 2008 will comply with APS 120. In the interim, the ASF looks forward to working with APRA in the lead up to the implementation.

- **Transitional Arrangements**

In the Discussion Paper accompanying draft APS 120, APRA has invited submissions in relation to the transitional arrangements.

It is normal practice that the regulatory compliance of a transaction is measured with regard to the position as at the date of commencement of the transaction and that new laws and regulations subsequent to that date, do not operate retrospectively in relation to such transactions. The ASF, therefore, recommends that the new APS 120 should apply only in relation to securitisations with a completion/settlement date after its commencement (that is on and from 1 January 2008).

If the new APS 120 were to apply to existing securitisations, an enormous amount of work would need to be undertaken by ADIs to review those transactions to identify the changes necessary in order to comply with the new APS 120. In addition, the documentation for most securitisations provides for a process of amendment, including obtaining rating agency approvals, consents of key parties and, in some circumstances, note holder approval. The latter would involve notices being sent to note holders and the convening of meetings of note holders. Given the international nature of the Australian securitisation market, this would involve an enormously expensive logistical exercise in relation to the holding of note holder meetings in offshore jurisdictions. Overall, therefore, the ASF believes that the resources that would be required to review and amend existing securitisation transactions is unlikely to justify the prudential benefits that would be obtained from such a process. Accordingly, the ASF recommends that all existing transactions under the former APS 120 should be grandfathered.

- **Self Assessment**

Paragraph 10 (*Notification*) of the draft prudential standard APS 120 requires that prior to the execution of a new securitisation or an amendment to an existing securitisation an ADI must provide a self-assessment evidencing its compliance with the standard and obtain written approval of the regulatory capital treatment to be applied and a legal opinion be submitted to APRA by the ADI to confirm compliance with APS 120.

In summary, the ASF submits that:

1. ADIs should be permitted to undertake self-assessment in determining the regulatory capital treatment for securitisation transactions and that APRA's approval of the self-assessed capital treatment not be required prior to the transaction close;

2. A checklist be agreed with APRA; and

3. Legal Opinions and other sign offs should not be required to confirm compliance to APS 120 apart from the true sale and enforceability opinions required under the current standards (this is discussed further below). Further, these should be provided at the same time as the completed self assessment checklist (i.e. not prior to transaction close).

International competitors that are not subject to a pre-approval requirement will be at a competitive advantage in bringing transactions to the market and Australian ADIs will be at a significant disadvantage. The ASF notes that, for instance, institutions regulated by the FSA are permitted to self-assess the regulatory capital treatment for securitisation transactions. The yields on asset backed securities are volatile and will depend on issuer supply and investor demand (i.e. pricing can change from week to week), it is therefore very important for sponsors of these transaction to be able to bring them to market in a timely fashion. Requiring APRA's pre-approval of each transaction will put significant pressure on an Australian ADI's ability to execute transactions in a manner which optimises their effectiveness as a financing tool.

The proposed self-assessment will be more robust than the approach adopted by, for instance, the FSA by requiring the ADI to provide APRA with a checklist for consultation. This, along with APRA's review into ADIs operational risk management framework should provide APRA with comfort as to the capability of an ADI to properly self-assess regulatory capital treatment of securitisation exposures. Additionally, a number of ADIs already undertake a form of self-assessment and do not obtain prior written approval from APRA for each new transaction. This process for determining regulatory capital treatment has worked well to date and would, in the ASF's opinion, continue to do so under the new standard. Naturally the ADI will take the risk of its self-assessment proving to be wrong (e.g. by a subsequent audit by APRA).

The ASF would like to work with APRA to develop a checklist (that is submitted after the deal has been completed within an agreed timeframe) which includes:

- (1) a high level summary of the transaction;
- (2) the proposed capital treatment; and
- (3) highlight any changes/dissimilarities to earlier transactions (if applicable).

The proposed checklist will be a simplified version of the checklist that is currently required by APRA.

The ASF suggests that the form of the checklist be agreed with APRA by 13 April 2007.

- **“Originating ADI”**

The ASF Notes the insertion of a new definition of “originating ADI”. This term has a very wide meaning, does not always appear to be used consistently and sometimes appears to be used in areas where the ASF submits, it is not appropriate to capture facility and service providers. An “originating ADI” for example, includes an “ADI if it provides a facility or service to a third party securitisation”. An ADI therefore that provides lending, derivative or underwriting facilities to a third party transaction is an “originating ADI”. It is not clear when requirements of the draft APS 120 need to be satisfied to ensure that such an ADI does not need to hold capital against the assets of the third party securitisation. The ASF therefore submits that the use of the term

“originating ADI” throughout the standard should be reconsidered. The ASF also suggests that a term such as “Seller ADI” or “Sponsoring ADI” should be introduced to cover those circumstances where an ADI has directly or indirectly originated assets and is selling/has sold those assets to the SPV.

This is discussed in more detail in Annexure A.

- **Legal Opinions**

The ASF Notes that the draft standard has introduced a requirement for ADIs to obtain legal opinions confirming the compliance by the ADI to APS 120. The ASF submits that this requirement is unnecessary and unlikely to achieve APRA’s objectives. It is likely that legal counsel will be unable to opine on an ADI’s compliance with a number of aspects of the draft standard. Opinions will be heavily qualified. Each opinion will require a significant amount of work and the material cost of that opinion (whether provided by internal or external counsel) would need to be factored into each transaction.

The ASF therefore believes that the cost of obtaining such an opinion will significantly outweigh the level of comfort which the opinions are intended to give.

The ASF further notes the ability for APRA to require an external legal opinion from a law firm chosen by APRA. There is no guidance/restrictions on when such an opinion would be required. The ASF submits firstly, that there should be some guidance/ restrictions as to when such an opinion may be requested. Secondly, the ASF submits that it may be difficult to find an independent law firm not already involved in the transaction that is qualified and willing to opine and that therefore the normal transaction opinion provided by the sponsors external lawyers should be sufficient.

These points are discussed in more detail in Annexure A.

- **Eligible Facilities**

The ASF notes the introduction of a number of requirements for an “eligible facility”. An “eligible facility” will receive a more favourable capital treatment than a facility that fails the various eligibility tests. The tests are quite stringent and impose a number of requirements which the ASF submits are non-commercial. In addition, some of the requirements, in a rated securitisation programme, would result in ratings agencies imposing additional and costly requirements on the ADI provider – such as a requirement to “cash collateralise” its obligation upfront. The ASF notes that these various facilities are given a different and harsher capital treatment than a corresponding facility from an ADI to a non securitisation counterparty. The ASF submits that there should be no reason for this different treatment and that the concept of “eligible facilities” should be abandoned. As mentioned in relation to legal opinions, the requirements for a special legal sign-off for such a facility should also be dropped.

This is discussed in more detail in Annexure A.

Further, the ASF requests APRA to clarify the dividing line between the operation of APS 120 and APS 112 & 113. For example, if an ADI provides an unrated warehouse facility, that facility will be risk-weighted at 100% under APS 112, but treated as a deduction from capital under APS 120 (assuming that the ADI has adopted the standardised approach). However, there is no guidance as to which Prudential Standard is to apply to warehouse facilities for securitisation structures.

Some warehouse facilities, such as for prime mortgages, are 100% fully funded by the relevant warehouse provider and so it is arguable that these do not constitute a "securitisation". However, traditionally sub-prime mortgage warehouses and warehouses for other asset classes have a subordinated note. In this situation the two tier note structure could be regarded as satisfying the definition of a "securitisation". Given the huge difference in capital treatments, it is obviously very important that all warehouse facilities be regulated as normal lending facilities under APS 112 or APS 113 (as applicable) rather than being treated as securitisation exposures under APS 120.

This is also discussed in more detail in Annexure A.

- **Servicing and Managing**

The ASF notes the introduction of a requirement for SPVs and investors to have the express and unfettered right, during the lifetime of the transaction, to select an alternative party to provide the relevant service. The ASF submits that this is an uncommercial approach. Whilst agreeing that the SPV should have the right to select any party that it sees fit to act in those roles, once the servicer/manager has been chosen and contracted to the role, the SPV and investors should not have rights to select another party to perform the roles except under normal commercial circumstances, such as where the servicer or manager resigns or is liable to be replaced due to some breach of its contractual obligations. The role as manager and servicer earns valuable fees for the ADI and it is difficult to see how this provision could be necessary to protect either depositors or investors.

This point is discussed further in Annexure A.

- **Acquisition of Exposures From SPVs by ADIs**

The ASF notes that an originating ADI (which we assume would be the ADI that originally originated the exposures, as opposed to any ADI providing a facility or service) may repurchase exposures from an SPV where a 10% clean up call is being exercised or where granting a further advance in cases where the originating ADI acts as servicer. In all other circumstances (except we assume, pursuant to a breach of warranty in the first 120 days) APRA pre approval must be sought. The ASF submits that there are a number of points surrounding the relevant paragraphs that need to be clarified. Those points are:

1. Are the relevant paragraphs really intended to apply only to the ADI that directly or indirectly originated the relevant assets and sold them into the SPV?
2. Are these two circumstances the only 2 circumstances under which an ADI may purchase assets from an SPV?
3. Is the 10% limit still intended (the ASF notes that Charles Littrell's comments in his address to the recent ASF securitisation conference and the Discussion Paper accompanying draft APS 120, both suggest that the 10% limit is to be removed).


The ASF also submits that the relevant provision should be extended to allow assets to be purchased from an SPV pursuant to a "liquidity asset purchase agreement." A liquidity asset purchase agreement operates in a similar way to a liquidity loan agreement in an asset backed commercial paper programme. The difference is that, instead of making a loan to the securitisation vehicle ("SPV"), the ADI purchases assets from the SPV to improve its security position. Liquidity asset purchase agreements are common in the U.S. commercial paper market.

Finally, the ASF submits that provisions should be included in ASF 120 allowing for date based call options. As a minimum, the ASF submits that date based calls should be permitted in circumstances where exercise by the SPV of the call does not result in purchase of the exposure by the ADI that originated the assets (for example where they are purchased by another SPV) .

These points are discussed further in Annexure A.

We trust that the ASF's submission will be of assistance to APRA in finalising APS 120- Securitisation and that APRA will look favourably on our comments when preparing the second draft. Representatives of the ASF are happy to meet with you, at any time, to further discuss APS 120 and our submission.

Yours faithfully,



Roger Desmarchelier  
Chairman  
Australian Securitisation Forum  
Ph: (02) 9320 5605  
Mob: 0412 497 348



Kevin Lee  
Chair, Prudential Committee  
Australian Securitisation Forum  
Ph: (02) 8232 8577  
Mob: 0404 857 206

**Annexure A**  
**to the submission**  
**dated 2 February 2007**  
**on**  
**Draft APS 120**  
**by**  
**The Australian Securitisation Forum**

**[COAT OF ARMS OF AUSTRALIA NOT REPRODUCED]**

## Prudential Standard APS 120

### Securitisation

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

This Prudential Standard aims to ensure that authorised deposit-taking institutions adopt prudent practices in managing the risks associated with securitisation and that appropriate regulatory capital is held against those risks.

An authorised deposit-taking institution to which this Prudential Standard applies must comply with the requirements of this Prudential Standard on a stand-alone (Level 1) basis and, where the authorised deposit-taking institution is a member of a consolidated banking group, on a consolidated banking group (Level 2) basis.

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

- hold regulatory capital against all securitisation exposures that it retains or acquires;
- stand clearly separate from a securitisation with the extent of the institution's obligations to the securitisation set out in legal documentation; and
- ensure that there is clear disclosure that its involvement in a securitisation does not extend beyond any specific undertakings to which it has formally committed itself.

## Authority and application

1. This Prudential Standard is made under paragraphs 11AF(1)(a) and 11AF(1AA)(a) of the *Banking Act 1959* and, subject to paragraph 2, applies to all authorised deposit-taking institutions (**ADIs**).
2. An ADI that is not a foreign ADI must comply with all of the provisions of this Prudential Standard. A foreign ADI must comply with the provisions in this Prudential Standard relating to disclosure and separation (including paragraphs 11 to 13 and Attachment A).<sup>1</sup>
3. A reference to an ADI (or ADIs) in this Prudential Standard shall be taken as a reference to:
  - (a) an ADI (or ADIs) on a stand-alone **Level 1** basis; and
  - (b) an ADI (or ADIs) on a consolidated banking group **Level 2** basis.

Further details on how this Prudential Standard applies on a Level 1 and Level 2 basis are set out in *Prudential Standard APS 110 Capital Adequacy (APS 110)*.

4. By operation of section 13(1) of the *Legislative Instruments Act 2003*, terms not defined in this Prudential Standard but which are defined in the *Banking Act 1959* have the same meaning as in the *Banking Act 1959*.

## Definitions

5. The following terminology is used in this Prudential Standard when describing securitisation:

**[ASF Note: It would be preferable for all defined terms in this paragraph 5 to be arranged alphabetically as this will aid readability of the Prudential Standard.]**

- (a) **securitisation** – a structure where the cash flow from a pool (refer sub-paragraph 5 (b) below) is used to service obligations to at least two different tranches or classes of creditors (typically including holders of debt securities), with each class or tranche reflecting a different degree of credit risk (i.e. one class of creditors is entitled to receive payments from the pool before another class of creditors). Payments to the creditors depend upon the performance of the pool and are not primarily derived from an obligation of the ADI that originates the securitisation, except to the extent permitted under this Prudential Standard and as specified in the documentation provided to investors;

**[ASF Note: We request that the word “primarily” be inserted**

<sup>1</sup>

<sup>1</sup> ‘Foreign ADI’ has the meaning given in Division 1B of Part II of the *Banking Act 1959*.

before the word “derived” to reflect the common market practice whereby the sponsoring ADI provides a liquidity facility or other form of liquidity or credit support which are used to support obligations owed to creditors.

In addition, the ASF is concerned about the position of warehouse facilities and considers that these should be carved out of the definition of “securitisation”. In many warehouse facilities (such as prime insured mortgaged backed warehouse facilities), there will only be a single tranche of creditor which would not be governed by APS 120. These would be governed by APS 112 or APS 113. It is for these reasons and for certainty and consistency of approach that the ASF submits that all warehouse facilities should be carved out of the definition of securitisation.]

- (b) **pool** – the underlying exposure or exposures that are securitised either by way of sale or the transfer of credit risk. The pool may consist of, but need not be limited to, loans, bonds or equities;
- (c) **traditional securitisation** – a securitisation where the pool is transferred to, and held by, a special purpose vehicle;
- (d) **synthetic securitisation** – a securitisation whereby only the credit risk, either in whole or in part, of a pool is transferred to a third party, which is not necessarily a special purpose vehicle;<sup>2</sup>
- (e) **special purpose vehicle (SPV)** – a financing vehicle which typically, in a traditional securitisation, purchases and holds the pool or, in a synthetic securitisation, enters into a credit derivative, guarantee or other credit risk transfer mechanism, for the purposes of a securitisation. The SPV’s payment for the pool or in respect of its assumption of credit risk is typically funded by debt, including units or securities, issued by the SPV;
- (f) **securitisation exposures** – retained or acquired on- and off-balance sheet risk positions arising from a securitisation held by an ADI including:
  - (i) investments in securities issued by an SPV;
  - (ii) retention of a subordinated tranche of securities issued by an SPV;
  - (iii) credit enhancements, such as guarantees and reserve accounts provided in relation to a securitisation;

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<sup>2</sup>

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.

- (iv) extension of funding or liquidity facilities; and
  - (v) exposures arising from derivative transactions with an SPV.
- (g) **credit enhancement** – a contractual arrangement in which an ADI holds a securitisation exposure and, in substance, provides some degree of added credit protection to other parties to the securitisation (typically other security holders). A **first loss** credit enhancement provides a first level of financial support to an SPV and/or its investors. A **second loss** credit enhancement is a second tier of protection to an SPV and/or its investors;
- (h) **implicit support** – financial support or recourse to the ADI that is provided to a securitisation by an ADI that is in excess of the ADI's explicit contractual obligations;
- (i) **originating ADI** – an ADI that directly or indirectly originates underlying exposures included in the pool. Originating ADI also includes an ADI that acts as a sponsor of a securitisation where the SPV acquires exposures from third-party entities. ~~An ADI is a sponsor and, in turn, an originating ADI if it provides a facility or service to a third party securitisation. A managing or servicing ADI is an originating ADI;~~

[ASF Note: The concept of “originating ADI” has broad usage in this Prudential Standard. We believe that express reference to this term and the terms “managing ADI” and “servicing ADI” should be used more specifically where managing or servicing activities are involved and that the catch-all sentence at the end of this definition should be avoided. It is clear that a “managing ADI” and “servicing ADI” will not be an “originating ADI” in some instances – see for example the servicing and managing requirements in Attachment E at paragraph 23 and following. It is submitted that the Prudential Standard should refer to the specific concepts of “originating ADI”, “managing ADI” and “servicing ADI”. This will make clearer throughout the Prudential Standard how the Prudential Standard is to apply to ADIs by reference to the capacity in which the ADI is acting.]

We also note that in relation to the provision by an ADI of facilities and services to third party securitisations, it is not clear in the Prudential Standard and Attachments which requirements will need to be met by the ADI in relation to such facilities and services. This needs to be clarified.

We included the additional words referencing paragraph 16 of Attachment B to overcome unintended consequences where a “facility” or “service” is provided by an ADI to a third party securitisation. By way of example, an ADI which only provides a derivative to a third party securitisation will be an

“originating ADI” and thus precluded from acquiring securitisation exposures of an SPV (unless it satisfies the tests in Paragraph 28 and Attachment F). It appears to the ASF that this is unintended.

The ASF submits that the Prudential Standard should deal separately with ADIs which only provide facilities and services which do not constitute the origination of underlying exposures.

One alternative may be for APRA to settle a new definition of “sponsoring ADI” which addresses APRA’s concerns, but which also clarifies the operation of the Prudential Standard in respect of them and allows ADIs to better manage its compliance with the Prudential Standard.]

- (j) **indirect origination** – where the ADI, either itself or using a third party, originates exposures directly into an SPV rather than transferring exposures from its balance sheet;
- (k) **servicing ADI** – an ADI that services the pool by collecting ~~principle~~ principal and interest from the underlying obligors;
- (l) **managing ADI** – an ADI that manages a securitisation. This may include undertaking responsibility for the day-to-day administration of the issuing 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, refinancing or calling of securities;
- (m) **facility** - a facility provided by an ADI to a securitisation including credit enhancements (including spread accounts), liquidity and funding facilities, underwriting of securities issued by an SPV and derivative transactions with an SPV;

[ASF Note: Please see our comments in relation to the definition of “securitisation” in respect of warehouse facilities.]

- (n) **service** – a service provided by an ADI to a securitisation including the offering of advice to investors or an SPV, servicing a pool and managing a securitisation;
- (o) **liquidity facility** – a facility provided by an ADI directly to an SPV to enable the SPV to ~~ensure assure investors of~~ timely repayments to investors of principal and interest on securities issued by the SPV;
- (p) **underwriting facility** – a facility under which an ADI agrees to buy a specified quantity of securities on a specified date and at a given price, before the SPV issues them in a new securitisation (as distinct from the ADI agreeing directly to acquire exposures in the pool);

- (q) **funding facility** – a facility provided by an ADI to an SPV for the purchase of exposures for a pool (not being funding provided through the ordinary purchase of securities issued by the SPV);
- (r) **asset backed commercial paper (ABCP) securitisation** - a securitisation that predominantly issues commercial paper with an original maturity of one year or less that is backed by assets or other exposures in an SPV;
- (s) **commercial paper** – a debt instrument having a scheduled term to maturity of less than 364 days;

[ASF Note: Given the many references to “commercial paper” in APS 120 and its Attachments the ASF considers that this definition should be included.]

- (st) **basis swap** – a variable versus floating interest rate swap that is used in a securitisation to protect investors against decreases in the spread between the benchmark interest rate received on a pool consisting (wholly or partly) of variable interest rate exposures and the benchmark floating interest rate paid on the issued securities; and
- (tu) **early amortisation clause** – a contractual clause that, when triggered, will result in security holders in a securitisation being paid out, in full or in part, prior to the originally stated maturity of the issued securities. Such clauses are generally included in the securitisation of revolving exposures.<sup>3</sup>

## Scope

6. This Prudential Standard applies to all roles undertaken by, and investments of, an ADI in a securitisation.<sup>4</sup> This includes, but is not limited to, where the ADI establishes and sponsors a securitisation, or provides a facility or service to a securitisation, including a securitisation that is sponsored by one or more independent parties. This Prudential Standard also captures securitisations where the pool is originated by an ADI but is never recorded on the ADI’s balance sheet, i.e. indirect origination.
7. An ADI must apply this Prudential Standard to securitisation exposures in its banking book. Securitisation exposures that are held in an ADI’s trading book are subject to the requirements of *Prudential Standard APS 116 Capital Adequacy: Market Risk (APS*

<sup>3</sup> Securitisation of revolving exposures refers to a structure whereby a pool consists, wholly or partly, of exposures wherein the obligors are permitted to vary their drawn amount within an agreed limit under a line of credit.

<sup>4</sup> An ADI may have a number of roles in a particular securitisation and in some instances its sole role may be that of an investor in the securities of a securitisation.

**116).**<sup>55</sup> Notwithstanding this, securitisation exposures that are required to be deducted from capital if they are held in an ADI's banking book must be treated in an equivalent manner if they are held in the ADI's trading book; i.e. they must be deducted from capital.

8. This Prudential Standard applies to traditional securitisation, synthetic securitisation and combinations of both traditional and synthetic securitisation. If a particular structure has similar characteristics to a securitisation, an ADI must apply to APRA for a written determination of its classification.
9. The issuing of full recourse debt instruments that are secured by a "cover" pool (**covered bonds**) of high quality exposures held by an ADI and that provide, in the case of insolvency of an ADI, the holders of securities with a priority claim on that cover pool, is not considered to be a securitisation for the purposes of this Prudential Standard. Covered bonds are not considered to be consistent with depositor preference provisions set out in the *Banking Act 1959* and hence are not permitted.

### Notification

10. In advance of undertaking a new securitisation or modifying an existing securitisation, an originating ADI must provide a self-assessment evidencing compliance with the requirements of this Prudential Standard to APRA, and obtain APRA's written approval of the appropriate regulatory capital treatment that must be applied.

**[ASF Note: Please see the ASF's comments on this requirement and requested drafting changes in the cover letter accompanying this annexure.]**

### Disclosure and separation for originating ADIs

11. The nature and limitations of an ADI's involvement in a securitisation must be clearly disclosed to investors. In particular, it must be made clear that an investment in the securitisation does not represent a deposit with or other liability of the ADI.
12. An ADI must deal with an SPV and its investors on an arm's length basis and on market terms and conditions. The ADI's involvement in securitisation must be set out in legal documentation and be limited as to time and amount.
13. An ADI must not provide implicit support to a securitisation. If this prohibition is breached, APRA will require the ADI to disclose any implicit support it has provided to a securitisation. Such disclosure

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<sup>5</sup> An ADI's securitisation exposures may be allocated to its banking or trading book according to the ADI's trading book policy statement (refer *Guidance Note AGN 116.1 The Trading Book and Trading Book Policy Statement (AGN 116.1)*).

must be in accordance with [the relevant pillar 3 disclosure instrument (to be released)] including details of any implicit support and its capital impact.

### Capital adequacy

14. An originating ADI of a traditional securitisation may exclude the underlying exposures in the pool from the calculation of its regulatory capital requirement and, where applicable, expected losses<sup>6</sup>, if the credit risk associated with that pool has been transferred to third parties and the transfer complies with the relevant requirements in Attachment B. An originating ADI may recognise certain credit risk mitigation techniques in a synthetic securitisation subject to the relevant requirements in that same Attachment.
15. An ADI must hold regulatory capital (as detailed in this Prudential Standard) against any securitisation exposure that it holds.
16. There are two broad approaches for determining the regulatory capital requirement for securitisation exposures: the standardised approach and the internal ratings-based (**IRB**) approach.
17. An ADI that applies the standardised approach to credit risk (refer *Prudential Standard APS 112 Capital Adequacy: Standardised Approach to Credit Risk (APS 112)*) to determine the regulatory capital charge for credit risk for the type of exposures in a pool must use the standardised approach for the calculation of its regulatory capital requirement for securitisation exposures (refer Attachment C).
18. An ADI that has approval from APRA to use the internal ratings-based approach to credit risk (refer *Prudential Standard APS 113 Capital Adequacy: Internal Ratings-based Approach to Credit Risk (APS 113)*) to determine the regulatory capital charge for credit risk for the type of exposures in a pool must use the IRB approach for the calculation of its regulatory capital requirement for securitisation exposures (refer Attachment D). Where there is no specific treatment detailed in APS 113 for the type of exposures in a pool, the ADI must calculate its regulatory capital requirement for that securitisation exposure using the standardised approach.
19. If an ADI has obtained approval from APRA to use APS 113 for some exposures in a pool and it uses APS 112 to determine the regulatory capital charge for credit risk for other exposures in that pool, the ADI must obtain written approval from APRA regarding the approach to be applied to its securitisation exposures.
20. In the case of the securitisation of revolving exposures, if an early amortisation clause is triggered when the quality of the pool deteriorates, regulatory capital must be held by the ADI that has

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<sup>6</sup> For the exclusion from the calculation of expected losses refer to *Guidance Note AGN 113.6: Internal Ratings Based Approach to Credit Risk: Treatment of expected losses and recognition of eligible provisions (AGN 113.6)*.

transferred a pool to provide cover for the upcoming return of the pool (refer Attachment G).

[ASF Note: This paragraph 20 suggests that upon amortisation in this situation the pool will be returned to the ADI. There are situations where amortisation because of pool deterioration will not necessarily result in a return of the pool to the ADI. The ASF's view is that paragraph 20 should not require regulatory capital to be held until the earlier of the ADI being contractually committed to purchase the pool and the ADI purchasing the pool.]

21. If APRA determines that an ADI's regulatory capital requirement is not commensurate with the totality of the risks arising from its involvement in securitisation or where the ADI does not comply with the requirements of this Prudential Standard, APRA may, in writing, require the ADI to:
  - (a) maintain additional regulatory capital above the ADI's minimum regulatory capital requirement; or
  - (b) hold regulatory capital against the relevant pool(s) (refer APS 112 or APS 113) or the full value of all securities issued by the relevant SPV(s).
22. An ADI providing implicit support to a securitisation must, at a minimum, hold regulatory capital in accordance with paragraph 13, against all of the securitised exposures associated with the securitisation transaction issued securities by the relevant SPV(s) as if they had not been securitised.

[ASF Note: We note that as currently drafted, this paragraph 22 is not consistent with the Basel II Framework (refer to paragraph 564) or with the UK Financial Services Authority's approach as set out in BIPRU Rule 9.2.2. Accordingly, we request that the above amendments be made so as to make the concept of implicit support consistent with the Basel II Framework. This would mean that if an ADI provides implicit support, the ADI should be required to hold regulatory capital against all of the securitised exposures associated with the securitisation transaction as if they had not been securitised (and not the issued securities), as the regulatory capital requirement should only apply to the underlying exposures. ]

[We also note that throughout the Attachments to APS 120, there are deeming provisions where certain events have occurred which link back to this concept and require regulatory capital to be held in accordance with this paragraph – these are contained in paragraphs 1 of Attachment A, 21 and 27 of Attachment E and 7 and 12 of Attachment F. The ASF does not believe that this is consistent with the Basel II Framework and is not reflective of the actual risks which may arise. In these instances, the ASF is of the view that the consequence of a breach of the relevant requirement should be that any implicit support arising be commensurate with the increased risk

to the ADI. The ASF requests that the relevant paragraphs of the Attachments be reworked to reflect this concept. The reason for this is that where APRA determines that any implicit support exists in connection with a securitisation as a consequence of a breach of a requirement of APS 120, the effect should not be to automatically require capital to be held against all of the securities issued by the SPV. Rather, the regulatory capital effect should only reflect the increased risk to the ADI arising from the relevant underlying exposures.]

23. If APRA considers that the risks arising out of securitisation are not adequately addressed by holding additional regulatory capital, APRA may, in writing, impose limits on the extent to which additional exposures may be securitised by an ADI.
24. In exceptional circumstances, APRA may, in writing, preclude an ADI from continuing to undertake securitisation or require the ADI to transfer its securitisation exposures to a third party.

### **Board and senior management responsibilities**

25. It is the responsibility of the Board of Directors (**Board**) and senior management of an ADI to put in place policies and procedures relating to securitisation. These policies and procedures must, at a minimum, outline:
  - (a) appropriate risk management systems to identify, measure, monitor and manage the risks arising from the ADI's involvement in securitisation;
  - (b) how the ADI will monitor the effects of securitisation on its risk profile and how it has aligned its risk management practices; and
  - (c) how the ADI, in accordance with its normal credit guidelines, will assess the average asset quality of the exposures for which the ADI retains ownership (traditional securitisation) or credit risk (synthetic securitisation) subsequent to the securitisation.

[ASF Note: ADIs would typically assess any exposures in connection with a securitisation in accordance with their normal credit guidelines. If APRA does not agree with this approach, the ASF seeks clarification from APRA as to what will be required in this regard.]

26. An originating ADI must consider residual risks arising out of the exposures that have been securitised.

### **Facilities and services**

27. An ADI may provide facilities and services to a securitisation provided that the requirements of Attachment E are satisfied and the

ADI holds regulatory capital (as detailed in this Prudential Standard) against the securitisation exposures arising from the facilities it has provided.

### Acquisition of securitisation exposures

28. An originating ADI may acquire underlying exposures out of a pool held by an SPV where both:

- (a) the originating ADI acquires the underlying exposures pursuant to:
  - (i) the exercise of a clean-up call; or
  - (ii) the granting of a further advance when the originating ADI acts as a servicing ADI; and
- (b) the requirements in Attachment F are met,

or otherwise APRA's prior written approval is obtained.

[ASF Note: In this paragraph 28, it appears that an "originating ADI" (which would include an ADI that was a swap provider, dealer or provider of funding and who was otherwise acting on an arms length basis) can only acquire an underlying asset from a SPV in the two circumstances set out in paragraphs (a) and (b). The ASF submits that there needs to be a carve out for assets repurchased where there has been a breach of warranty – as permitted in paragraph 14 of Attachment F. In addition, the application of the paragraph should be limited to the ADI that originated the assets (to ensure a true sale) and should not prevent other ADI's acting on an arm's length basis from acquiring the assets.]

~~30~~29. Securities issued by the SPV must not be acquired by an originating ADI during the lifetime of the securitisation, unless the conditions in Attachment F are met and the volume of securities acquired by the originating ADI is not disproportionate to the amount of securities issued by the SPV, or, in exceptional circumstances, with APRA's prior written approval.

[ASF Note: It is submitted that it would be useful if APRA could either provide a definition of "disproportionate" or otherwise provide some guidance as to this concept in a footnote.]

30. Notwithstanding paragraphs 28 and 29, an originating ADI may acquire underlying exposures out of a pool held by an SPV in the circumstances set out in paragraph 14 of Attachment F.

[ASF Note: This amendment has been inserted to clarify that paragraph 14 of Annexure F is an exception to paragraphs 28 and 29. Further, in paragraph 30, an "originating ADI" (which again, would

include an ADI that was a swap provider, dealer or provider of funding and who was otherwise acting on an arms length basis) must not acquire securities unless the conditions in Attachment F are met including the 20% holding limitation. We will comment further on Attachment F later in this submission. The ASF notes that there is no such restriction on other “non securitisation vehicle” securities holdings by ADI’s and submits that securities issued by a securitisation vehicle should not be treated any differently. The ASF therefore submits that this paragraph should only apply to the ADI that indirectly or indirectly originated the assets or the ADI sponsoring the relevant securitisation programme.]

**Attachment A****Disclosure and separation requirements for originating ADIs***Disclosure*

1. An ADI involved in a securitisation must ensure that there is clear and prominent disclosure to investors of the nature and limitations of the ADI's obligations arising from its involvement in a securitisation. Documentation or marketing of a securitisation must not give the impression that recourse to the ADI would extend beyond any specific undertakings to which the ADI has formally committed itself. ~~An originating ADI that does not comply with the requirements in this Attachment will be considered by APRA to have provided implicit support and paragraph 22 of this Prudential Standard will apply.~~

[ASF Note: Please see our comments in relation to paragraph 22 of APS 120. We do not consider that the "deeming" of a breach of the requirements mentioned in this paragraph 1 should automatically lead to the consequence that there has been implicit support as defined in paragraph 22 of APS 120 and we do not believe that this is consistent or commensurate with the Basel II Framework or the manner in which other regulators have addressed implicit support. The ASF believes that to the extent a breach of the requirements mentioned in this paragraph 1 occurs, the consequences of such a breach should be referenced to the increased risk to the ADI arising from that breach. That is, the effect should not be to automatically require capital to be held against all of the securities issued by the SPV or the exposures which have been securitised. Rather, the regulatory capital effect should only reflect the increased risk to the ADI arising from the relevant underlying exposures to which the breach relates.]

2. An ADI must ensure that investors are unambiguously informed in writing that:
  - (a) their investments do not represent deposits with or other liabilities of the ADI;
  - (b) their investments are subject to investment risk, including possible delays in repayment and loss of income and invested principal; and
  - (c) the ADI does not, in any way, guarantee the capital value or performance of the issued securities or the performance of the exposures in the pool held by the SPV except to the extent permitted under this Prudential Standard and as specified in the documentation provided to investors.
3. The written disclosures required by this Attachment must be

included in all marketing documents, papers and electronic documents inviting investment.<sup>7</sup>

4. An ADI must ensure that any marketing or promotion of a securitisation with which it is associated does not give any impression contrary to the disclosure requirements detailed in this Attachment. Any proposal to modify the extent of these disclosures must be approved, in writing, by APRA.
5. Disclosures in documents inviting investment must be included as a stand-alone item on the inside front cover or within the first two pages of the documents. Where this conflicts with other statutory or regulatory requirements (e.g. *Corporations Act 2001*), disclosures must remain prominent and material variations to the presentation of the disclosures must be approved, in writing, by APRA.

**[ASF Note: It is submitted that minor immaterial variations should be permissible without APRA approval. This should also assist APRA in its administrative oversight and save resources in requiring only material changes to be approved.]**

- ~~6. An ADI must be able to demonstrate to APRA that all investors have provided a signed acknowledgement indicating that they have read and understood the required disclosures. To ensure the validity of the acknowledgement, the signature must appear in close proximity to the disclosures to be acknowledged. [Not used]~~
- ~~7. An ADI will not be required to obtain signed acknowledgements from investors where [Not used]~~

~~securities are issued and traded in an electronic environment if market arrangements make it impractical to obtain the signed acknowledgements because there is no application form or equivalent documentation completed by prospective investors.~~

**[ASF Note: It is submitted that these requirements are not necessary, particularly given the fact that the size and distribution of most transactions will mean that the acknowledgements will not be obtained. Indeed APRA acknowledges this in paragraph 7(a), and it is submitted that accordingly the requirement should be deleted. We also note that this requirement is not required by regulators in Europe or the United States.]**

8. If an ADI has limited ability to ensure the required level of disclosure (~~including signed acknowledgements~~), it must consult with APRA. If satisfied of the limited ability to meet required disclosure levels, APRA may approve, in writing, the disclosure

<sup>7</sup> These include any leaflet, brochure or internet site etc. that provides information to potential investors about the securitisation or securities issued by it, and any prospectus, profile statement or customer information booklet detailing the terms and conditions of the investment. Advertising material associated with newspapers, radio and television, will not, in the normal course, be required to detail these disclosures.

requirements that apply.

*Separation requirements between the ADI and the SPV*

9. ~~A securitisation~~ An SPV must be clearly separate from any ADI involved in the securitisation and there must be clear limitations governing the extent of an ADI's involvement in the securitisation. Any undertakings given by an ADI to an SPV must be expressed clearly in the legal documentation relating to the securitisation and must be fixed as to time and amount.

**[ASF Note: These amendments are designed to recognise that it is the SPV which should be separate from the ADI. We do not consider that it is appropriate or possible to require the "securitisation" to be separate from the ADI as, to the extent the ADI is involved in a securitisation, it will never be separate from it.]**

10. Any undertakings given by an ADI to an SPV or investors must be subject to the ADI's normal approval and control processes. An ADI must ~~retain evidence that it has taken all precautions to ensure that it is not~~ be obliged to support any losses suffered by the securitisation or the investors outside of those detailed in the supporting legal documentation.

**[ASF Note: The ASF submits that, as a practical matter it is difficult, if not impossible, to provide evidence of a negative fact and that the relevant clauses in the legal documents governing the transaction, together with the usual transaction opinion that is provided by the lawyers acting on the transaction as to enforceability, should provide sufficient comfort. In other words, the ASF submits that "retain evidence that it has taken all precautions to ensure that it is" should be deleted. The ASF also requests some clarification as to what "undertakings" APRA is referring to as well as some guidance as to the nature of what evidence is required to be retained to satisfy this requirement.]**

11. For the purposes of this Prudential Standard, an ADI must not:
- (a) own, or hold a beneficial interest <sup>8</sup> in any share capital, including ordinary shares or preference shares, of an SPV where the SPV is a corporation which would mean that the ADI controls (within the meaning of section 50AA of the Corporations Act 2001) that SPV;

**[ASF Note: It is submitted that there should not be a complete prohibition on the ability of an ADI to have an ownership interest in an SPV which is a corporation provided the ownership interest does not amount to a controlling interest. This is also consistent with the ability of an ADI to have**

<sup>8</sup> A spread account that complies with the conditions in Attachment E or an investment in securities that complies with Attachment F is not considered a beneficial interest.

representatives on the Board of an SPV (see sub-paragraph (d)) provided the ADI representatives do not comprise a majority of the Board.]

- (b) own, or hold any beneficial interest in, any share capital in a trustee where the SPV is a trust which would mean that the ADI controls (within the meaning of section 50AA of the Corporations Act 2001) that trustee;

[ASF Note: Please see our comments in relation to sub-paragraph (a).]

- (c) include, permit or acquiesce to the inclusion of the word “bank”, “building society”, “credit union”, “authorised deposit-taking institution” or “ADI” in the name of an SPV;
- (d) allow any of the ADI’s directors, officers or employees to sit on the Board <sup>9</sup> of an SPV unless the Board is made up of at least four members. The ADI, however, may be represented by one director on a Board of four to six directors and by no more than two directors in a Board of seven or more directors;
- (e) act, or allow any of its directors, officers or employees to act, in any circumstances as a trustee of an SPV, or in any similar role. The trustee must not be part of the group, as defined in Australian accounting standards, to which the ADI belongs; or
- (f) be liable for the obligations and liabilities of the SPV <sup>10</sup> (in particular, if the SPV makes losses, investors must not have a claim on the ADI).

12. ~~An ADI must obtain written advice from legal counsel that APRA’s separation requirements in paragraphs 9 to 11 have been met for each securitisation. An ADI must also seek written advice from legal counsel that the ADI is protected from any legal liability from investors in the securitisation, apart from the liabilities arising from the contracts into which the ADI has entered. [Not used]~~

13. ~~For the purposes of paragraph 12, if internal legal counsel is not available or does not have the appropriate expertise, an external legal opinion must be obtained for each securitisation. [Not used]~~

<sup>9</sup> An SPV may ~~be include~~ a company or a trust with a corporate trustee. References to the directors and Board of an SPV in this Prudential Standard apply equally to the directors and Board of the corporate trustee of an SPV which is a trust.

[ASF Note: We do not want to preclude the possibility of other types of SPVs eg limited partnerships which are common in the UK]

<sup>10</sup> This does not apply to the limited circumstances explicitly permitted by this Prudential Standard (e.g. where the ADI is permitted to hold securities in the SPV or it has provided a facility to the SPV).

14. ~~APRA may, at its discretion, require an ADI to seek a legal opinion on the separation requirements from an independent legal counsel chosen by APRA at the expense of the ADI. [Not used]~~

[ASF Note: It is submitted that it will not be possible or appropriate for legal counsel to provide meaningful opinions in relation to all of the matters contained in paragraphs 9, 10 and 11.]

Clearly, any such advice from an external or internal lawyer will need to be qualified. For instance, nothing can prevent an investor from making a claim against an ADI in connection with the ADI's role in a securitisation even if ultimately that claim proves unsuccessful. If, for instance, a sponsoring ADI has made misleading statements during the marketing of a transaction, then it is possible that those misleading statements will give rise to a claim against the ADI for any losses that the investors may suffer.

Further, a legal opinion cannot provide any comfort in respect of this risk. To the contrary, the legal opinion may in fact, based on its qualifications and assumptions, simply highlight to the recipients' additional areas where the ADI may be exposed.

The ASF appreciates how a legal opinion on certain discrete aspects (e.g., true sale) is beneficial but we are not convinced that it is appropriate to attempt to transform regulatory requirements into legal requirements particularly where these regulatory requirements are not expressed in legal terms or with the provision of a statute.

Further, we note that APRA has the unfettered right to require an additional legal opinion from independent legal counsel. This will obviously create a not inconsiderable additional expense for the sponsoring ADI. The ASF submits that there are a limited number of law firms with securitisation expertise and it is likely that at least one of them will already be acting for an ADI in relation to the transaction. Therefore, it could also be difficult for APRA to find an appropriately qualified law firm that isn't already involved in the transaction that would be willing to give such an opinion and that is independent of the relevant ADI.]

#### *Requirements for an SPV*

15. In a securitisation, an SPV must satisfy the following criteria:
- (a) the SPV must be a corporation, ~~or trust~~ or other entity organised for a specific purpose;

[ASF Note: This amendment is to allow for limited partnerships or other forms of SPVs which are not yet used in the Australian market.]

- (b) the purpose of the SPV must be clearly defined and the activities of the SPV are limited to those necessary to accomplish that purpose; and
- (c) the SPV must be financially independent of the ADI ~~and have separate personnel to the ADI.~~

[ASF Note: While the requirement for an SPV to be financially independent of the ADI is well understood, it is not clear how the requirement for the SPV to have separate personnel will apply where the SPV has none of its own personnel (other than office-holders, if it is a corporate SPV). In addition, we note that the rating agencies prohibit SPVs from having any employees. Clearly, as an ADI can now manage an SPV, the personnel managing the SPV may well be employees of the ADI. We submit that provided the “managing” requirements in paragraphs 23 to 27 of Attachment E and the separation requirements of paragraph 11 of this Attachment are satisfied where an ADI is involved in a securitisation, then the requirement that the SPV have separate personnel to the ADI should be removed.]

## Attachment B

### Capital adequacy principles

1. As securitisations may be structured in many different ways, the regulatory capital treatment of a securitisation exposure must be determined on the basis of its economic substance and having regard to its legal form accordingly the securitisation documentation must reflect the economic substance of the securitisation transaction.

**[ASF Note: The ASF submits that it would be preferable to determine the treatment of securitisation exposures based only on their economic substance. This would be consistent with Paragraph 538 of the Basel II November 2005 Accord and the UK Financial Services Authority's BIPRU Guidance Note 9.1.6 and Rule 9.5.2.]**

#### *Operational requirements for regulatory capital relief*

2. An originating ADI may exclude a pool of a traditional securitisation from the calculation of its risk-weighted assets and, where applicable, expected loss<sup>11</sup>, if, at both the time of risk transfer and afterwards:

- (a) the transferred exposures in the pool are legally isolated from the ADI in such a way (e.g. through the sale of assets) that the exposures are put beyond the reach of the ADI and its creditors, including on winding up in bankruptcy and receivership. The originating ADI must not:

- (i) be obliged to repurchase, from the transferee, the previously transferred exposures (except as permitted by paragraph 14 of Attachment F);

**[ASF Note: This amendment is to make clear that an originating ADI can be obligated to repurchase exposures as provided for in Attachment F.]**

- (ii) be obliged to retain the credit risk of the transferred exposures; or
- (iii) once the pool has been transferred, bear recurring costs from the securitisation;

**[ASF Note: In and of itself, the ASF is unsure why a limited obligation to fund recurring costs of the securitisation (obviously excluding interest and principal expenses) is problematic. It does not, of itself, suggest that the ADI is supporting the credit of the transaction. We note, for instance, that an ADI is permitted to fund the start up costs of a securitisation**

<sup>11</sup> Refer to AGN 113.6.

under paragraph 20 of Attachment B.]

- (b) the issued securities are not obligations of the ADI, such that investors who purchase the securities only have ~~claim~~ claims to the relevant pool and any other contractual claims available against the SPV;
- (c) the transferee is an SPV and the holders of the securities in that SPV have the right to pledge or exchange them ~~without restriction~~ subject to any restrictions contained in the relevant legal documentation;

**[ASF Note: The ASF considers this requirement is too restrictive and that SPVs should be able to impose restrictions on the pledging or exchanging of the SPVs securities by the holders of them (including originating ADIs). In essence, this provides that to achieve true sale the SPV and the holders of the securities in that SPV must have the right to pledge or exchange them without restriction. Clearly, this is not workable. The SPV will have a number of secured creditors who will have rights in respect of the assets pledged in support of their exposure to the SPV such that the holders of the securities or the SPV itself do not have unfettered control.]**

- (d) the credit risk associated with the ADI's securitisation exposures (for each securitisation) is not significant compared to the credit risk of the relevant pool had it not been securitised;
- (e) spread accounts satisfy the requirements detailed in Attachment E;
- (f) clean-up calls, representations and warranties provided by the ADI satisfy the conditions detailed in Attachment F;
- (g) the ADI does not, and is not required to:
  - (i) systematically alter the underlying exposures such that a pool's weighted average credit quality is improved;
  - (ii) increase a retained first loss position or credit enhancement after the inception of the securitisation;  
or
  - (iii) increase the yield payable in response to a deterioration in the credit quality of a pool to parties such as investors and third-party providers of credit enhancements;
- (h) where an undrawn commitment to lend has been transferred as part of the securitisation, the transfer is effected by novation or assignment and is accompanied by a formal acknowledgement of the transfer by the borrowers or debtors;

- (i) where revolving exposures are transferred, the conditions in paragraph 1 of Attachment G are satisfied; and
- (j) the document of transfer specifies that, if cash flows relating to an exposure in a pool are re-scheduled or re-negotiated, the SPV will be subject to the re-scheduled or re-negotiated terms.

**[ASF Note: The ASF submits that sub paragraphs (a), (b), (f), (g), (h), (i) and (j) are not appropriate to anyone other than the ADI that originated the assets and possibly the sponsoring ADI. This leads us to conclude that the whole paragraph was probably intended to only apply to the ADI that originated the assets. We therefore submit that the introductory words are changed to apply only to the ADI that originated the assets or the sponsoring ADI.]**

3. An originating ADI may recognise the use of credit risk mitigation techniques (i.e. credit derivatives, guarantees or eligible collateral) in a synthetic securitisation for regulatory capital purposes if, at both the time of risk transfer and afterwards:
  - (a) the transfer of credit risk through the use of credit risk mitigation techniques complies with the eligibility and other requirements of:
    - (i) for credit derivatives, [the relevant instrument for *Standardised Approach to Credit Risk: Treatment of Credit Derivatives in the Banking Book*];<sup>12</sup>
    - (ii) for guarantees, *Guidance Note AGN 112.3 Standardised Approach to Credit Risk: Simple Approach to Credit Risk Mitigation (AGN 112.3)*;<sup>13</sup> and
    - (iii) for eligible collateral, AGN 112.3 and *Guidance Note AGN 112.4 Standardised Approach to Credit Risk: Comprehensive Approach to Credit Risk Mitigation (AGN 112.4)*;<sup>14</sup>
  - (b) the instruments used to transfer credit risk do not contain terms or conditions that limit the amount of credit risk transferred such as clauses that:
    - (i) materially limit the credit protection or credit risk transference (e.g. significant materiality thresholds below which credit protection is deemed not to be provided even if a credit event occurs or those that allow for the termination of the protection due to a deterioration in the credit quality of the pool);

<sup>12</sup> For this purpose, SPVs are not recognised as eligible credit protection providers.

<sup>13</sup> For this purpose, SPVs are not recognised as eligible guarantors.

<sup>14</sup> For this purpose, eligible collateral pledged by SPVs is recognised.

- (ii) require the ADI to alter the composition of a pool to improve the weighted average credit quality of that pool;
  - (iii) increase the ADI's cost of credit protection in response to a deterioration in the credit quality of a pool;
  - (iv) increase the yield payable to investors and third party providers of credit enhancements in response to a deterioration in the credit quality of a pool; and
  - (v) provide for an increase in a retained first loss position or credit enhancement provided by the ADI after the inception of the securitisation;
- (c) the credit risk associated with the ADI's securitisation exposures (for each synthetic securitisation) is not significant compared to the credit risk of the relevant underlying exposures had the credit risk not been transferred through credit risk mitigation techniques;
- (d) spread accounts satisfy the requirements detailed in Attachment E;
- (e) clean-up calls, representations and warranties provided by the ADI meet the conditions detailed in Attachment F; and
- (f) where revolving exposures are transferred, the conditions in paragraph 1 of Attachment G are satisfied.
4. An originating ADI must assess its compliance with paragraph 2 or 3 (as appropriate) and obtain written advice from legal counsel that the transferred exposures are legally isolated from the ADI in such a way that the exposures are put beyond the reach of the ADI and its creditors including on winding up it complies with these conditions. If internal legal counsel is not available, or does not have the appropriate expertise, an external legal opinion on that issue must be obtained for each securitisation. The legal opinion expert must also opine on give specific attention to the enforceability of the contracts against the SPV in all relevant jurisdictions.
5. ~~APRA may, at its discretion, require an ADI to seek a legal opinion on the operational requirements for capital relief from an independent legal counsel, chosen by APRA at the expense of the ADI.~~ [Not used]

[ASF Note: Please see our comments at paragraphs 12, 13 and 14 of Attachment A.]

*Maturity mismatches in synthetic securitisations*

6. The effective maturity of the tranches of securities issued in a

synthetic securitisation may differ from that of the pool, causing a maturity mismatch to occur. To determine if a maturity mismatch has occurred, the maturity of a pool must be compared with the maturity of the tranches of the securitisation. ~~For this purpose, the exposure in a pool with the longest maturity must be taken as the maturity of that pool.~~

**[ASF Note: It is submitted that the proper basis for determining exposures in a pool should be individually determined rather than by reference to the longest maturity in the pool.]**

7. A maturity mismatch exists where the residual maturity of the securitisation is shorter than the residual maturity of the pool.<sup>15</sup> In this case, full capital relief may not be recognised even if the synthetic securitisation otherwise complies with this Attachment. Instead, the capital requirement must be determined in accordance with:
  - (a) for credit derivatives, [the relevant instrument for *Standardised Approach to Credit Risk: Treatment of Credit Derivatives in the Banking Book*];
  - (b) for guarantees, Attachment C to AGN 112.3; and
  - (c) for eligible collateral, Attachment A to AGN 112.4.
8. Maturity mismatches may be ignored where deduction of the securitisation exposure is required for capital adequacy purposes in accordance with Attachments C or D.

*Operational requirements for the use of external credit assessments*

9. For the purposes of determining the regulatory capital requirement under this Prudential Standard (and, in particular, under Attachments C and D) for the securitisation exposures held, an ADI may only use an external credit assessment that takes into account all amounts, both principal and interest, owed to it.
10. Subject to paragraph 12 below, an ADI may only use the external credit assessments of the eligible external credit assessment institutions (**ECAIs**) as detailed in Attachment C of *AGN 112.1: Standardised Approach to Credit Risk: Risk-weighted On-balance Sheet Credit Exposures (AGN 112.1)*.
11. An ADI may only use external credit assessments of eligible ECAIs that are published in a form that is accessible to wholesale investors or participants in the relevant securitisation or to the general public

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15 A maturity mismatch may also occur if a synthetic securitisation incorporates a call (other than a clean-up call) that effectively terminates the transaction and the purchased credit protection on a specific date.

and are included in the eligible ECAI's transition matrix.<sup>16</sup> External credit assessments that are made available to a limited number of parties (including only to the parties in a securitisation) do not satisfy this requirement.

**[ASF Note: The ASF considers that this requirement is too restrictive. The ASF considers that a *private* rating by a rating agency is equally as valid an opinion on credit quality as a *public* rating. The ASF notes that rating methodology does not differ for public and private ratings. The ASF is concerned that, especially for commercial paper funded transactions, often ratings of the underlying trust or series exposures are *private* ratings and are not available to the general public. Therefore exposures such as those under liquidity facilities will not be able to be assessed based on the private ratings given. There are also some instances where an issuer/ seller (who may or may not be an ADI) may wish to have a private rating – due to the size or nature of the transaction. The effect of this provision merely penalises an ADI for being involved in such a transaction, but is not an indicator of the true risk involved. The ASF further submits that a privately rated transaction holds no greater risk to an ADI or its depositors, than the same transaction publicly rated, so the risk-weighting given by APRA to the two transactions should be no different. Accordingly the ASF recommends the above drafting changes to enable *private* ratings to be utilised.]**

12. An ADI must apply the external credit assessments of an eligible ECAI consistently across a given type of securitisation exposure. Where eligible ECAIs assess the credit risk of the same securitisation exposure differently, Attachment B of AGN 112.1 will apply. An ADI must not use the external credit assessments issued by one eligible ECAI for some tranches and those of another eligible ECAI for other tranches within the same securitisation. This applies regardless of whether some of the tranches are rated by one or another of the eligible ECAIs.

*Calculation of risk-weighted assets and regulatory capital for securitisation exposures*

13. For an on-balance sheet securitisation exposure, the risk-weighted asset amount of that exposure must be calculated by multiplying the exposure value<sup>17</sup> by the relevant risk-weight.<sup>18</sup>

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16 A transition matrix is a table of probabilities representing the likelihood, over a given time horizon, of a rating grade of a securitisation exposure migrating to other rating grades, remaining the same or experiencing default.

17 The exposure value of a securitisation exposure is its on-balance sheet value (i.e. net of specific provisions). The exposure value of a securitisation exposure arising from a derivative instrument will be determined by using the credit equivalent amount of the derivative calculated using the current exposure method (mark-to-market) i.e. replacement cost plus potential future exposure (refer AGN 112.2 Standardised Approach to Credit Risk: Risk-weighted Off-balance Sheet Credit Exposures (AGN 112.2)).

**[ASF Note: The opening sentence of this footnote regarding “net of specific provisions” appears to be inconsistent with AGN 112.2 which provides that the exposure at default for an on-balance sheet exposure is calculated gross of specific provisions. This is also consistent with the UK Financial Services Authority’s approach: see BIPRU Rule 9.9.4(2).]**

14. To determine the risk-weighted asset amount for an off-balance sheet securitisation exposure, an ADI must apply a **credit conversion factor (CCF)** to the securitisation exposure and risk-weight the resultant credit equivalent amount by the relevant risk-weight.<sup>19</sup> Unless otherwise noted in this Prudential Standard, a CCF of 100 per cent must be used.
15. Unless otherwise stated in this Prudential Standard, deductions from an ADI's capital must be made 50 per cent from Tier 1 capital and 50 per cent from Tier 2 capital (refer *Prudential Standard APS 111 Capital Adequacy: Measurement of Capital (APS 111)*). Deductions from capital may be calculated net of any specific provisions raised against the relevant securitisation exposure.
16. Overlapping securitisation exposures may occur where an ADI provides several types of facilities (e.g. a liquidity facility and a credit enhancement or a pool specific and program wide facilities). In some cases, the draw on one facility may preclude (in part) a draw on another facility. Where an ADI has two or more overlapping securitisation exposures in a securitisation, it must, to the extent that these positions overlap, include in its calculation of risk-weighted assets only that securitisation exposure, or portion of securitisation exposure, that produces the highest regulatory capital requirement. However, if overlapping facilities are provided by different ADIs, each ADI must hold regulatory capital for the entire amount of their respective facilities.

#### *Treatment of credit risk mitigation for securitisation exposures*

17. Where credit risk mitigation is provided directly to an SPV by an eligible guarantor (as defined in AGN 112.3) other than the ADI, and this is reflected in the external credit assessment assigned to a securitisation exposure, the risk-weight associated with that external credit assessment may be used. In order to avoid any double counting, no additional capital relief is permitted.
18. Where the credit risk mitigation is provided directly to an SPV by a guarantor that is not recognised as an eligible guarantor (as defined in AGN 112.3), and the credit risk mitigation is reflected in the external credit assessment assigned to a securitisation exposure, the guaranteed exposure must be treated as unrated.

**[ASF Note: If the rating agencies are satisfied with the credit rating of the exposure even though the guarantee is not from an "eligible guarantor", the ASF considers that this should suffice to treat the exposure as rated.]**

19. Where the credit risk mitigant is applied directly to a specific securitisation exposure (e.g. a specified residential mortgage backed

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18 Risk-weights for ADIs using the standardised approach are detailed in Attachment C. Risk weights for ADIs using the IRB approach are detailed in Attachment D.

19 Refer footnote 17.

securities tranche guaranteed by a highly rated third party) within a given structure, the ADI must treat the exposure as unrated and then use the credit risk mitigation treatment detailed in AGN 112.3 to recognise the credit risk mitigant.

*Start up costs*

20. Where an ADI contributes to the start up costs of a securitisation, these costs must be deducted from the ADI's Tier 1 capital (refer APS 111) as capitalised expenses. The ADI must also ensure that the:
- (a) contributed funds are not intended to protect investors against credit losses;
  - (b) funds involved represent a one-off commitment;
  - (c) amounts involved are strictly limited and are in line with normal market expenses for similar securitisations; and
  - (d) contribution of funds is not linked to the provision of any specific facilities by the ADI.

## Attachment C

### Standardised approach

#### *Maximum capital requirement*

1. Where the regulatory capital requirement for a securitisation exposure under the standardised approach is higher than the credit risk capital requirement (as determined by APS 112) that would have applied to the pool of exposures had it not been securitised, an ADI may, if APRA gives its approval in writing, apply the lower of the two capital charges. In addition, an ADI must deduct from Tier 1 capital the entire amount of any gain-on-sale from a securitisation.

#### *Risk-weights*

2. As detailed in Attachment B, the risk-weighted asset amount of a securitisation exposure must be calculated by multiplying the exposure value, or in the case of an off-balance sheet exposure, the credit equivalent amount, of the exposure by the risk-weight associated with the exposure's external rating grade (refer paragraphs 3 to 4 as appropriate).
3. The long-term external rating grades and corresponding risk-weights are:

External rating grade <sup>20</sup>	1	2	3	4	5,6 and unrated
Risk weight	20%	50%	100%	350%	Deduction from capital

4. The short-term external rating grades and corresponding risk-weights are:

External rating grade <sup>21</sup>	1	2	3	4 and unrated
Risk weight	20%	50%	100%	Deduction from capital

#### *Exceptions to the general treatment of unrated securitisation exposures*

5. As detailed in paragraphs 3 and 4, the general treatment of unrated securitisation exposures is deduction from capital. Exceptions to this general treatment are as follows:
  - (a) the most senior exposure in a securitisation (refer paragraphs 6 to 8);
  - (b) for ABCP securitisations, an exposure that is in a second loss, or better, position (refer paragraphs 9 to 10);

20 Refer Attachment C of AGN 112.1.

21 Refer footnote 20.

- (c) an eligible facility detailed in Attachment E; or
- (d) an eligible servicer cash advance as detailed in Attachment E.

*Treatment of most senior unrated securitisation exposures*

6. If the most senior exposure in a securitisation (e.g. the most senior tranche of securities issued by the SPV) is unrated, an ADI that holds such an exposure may determine the risk-weight to be applied against the exposure by using the **look-through** approach.

**[ASF Note: The ASF queries whether this should also apply to non-securities that are otherwise debt, e.g. liquidity and redraw facilities, which are structured as loans rather than securities.]**

7. In the look-through approach, the average risk-weight of the pool may be used as the risk-weight for the most senior securitisation exposure if an ADI can demonstrate to APRA (and APRA determines in writing that it is satisfied) that the ADI is:
- (a) at all times, aware of the composition of the pool; and
  - (b) able to determine the relevant risk-weight (as determined by APS 112) that is applicable to each individual exposure in the pool.
8. When using the look-through approach, an ADI is not required to consider interest rate swaps, currency swaps or eligible servicer cash advances as detailed in Attachment E in determining whether an exposure is the most senior in a securitisation.

*Treatment of exposures in a second loss, or better, position in an asset backed commercial paper securitisation*

9. An ADI is not required to deduct an unrated second loss position securitisation exposure in an ABCP securitisation where:
- (a) the exposure is economically in a second loss or better position and the first loss position provides significant<sup>22</sup> credit enhancement to the second loss position;
  - (b) the second loss position will only be drawn upon when the first loss position has been completely exhausted;

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22 A first loss position is considered significant when it covers a multiple of historical losses or worst-case loss calculated by the use of models and simulation techniques.

- (c) the ADI can demonstrate to APRA (and APRA determines in writing that it is satisfied) that the associated credit risk is the equivalent of an external rating grade of 3 or better;<sup>23</sup> and
  - (d) the ADI holding the unrated securitisation exposure does not retain, acquire or otherwise provide the first loss position.
10. A securitisation exposure to which paragraph 9 applies, may be risk-weighted at the greater of:
- (a) 100 per cent; or
  - (b) the highest relevant risk-weight (as determined by APS 112) for any of the underlying individual exposures supported by the second loss facility.

*Treatment of unrated eligible facilities*

11. The credit equivalent amount of an eligible facility, other than an undrawn eligible servicer cash advance (refer paragraph 13), that meets the requirements of Attachment E must be determined by:
- (a) applying a 20 per cent CCF to the notional amount of the eligible facility, if the eligible facility has an original maturity of one year or less; or
  - (b) applying a 50 per cent CCF to the notional amount of the eligible facility, if the eligible facility has an original maturity of more than one year.
12. The risk-weight to be applied to the credit equivalent amount is the highest relevant risk-weight (as determined by APS 112) for any of the underlying individual exposures covered by the eligible facility.

*Treatment of eligible servicer cash advance*

13. An ADI may apply a 0 per cent CCF to an undrawn eligible servicer cash advance that meets the requirements of Attachment E.

*Treatment of credit risk mitigation for securitisation exposures*

14. The risk-weight applied to a securitisation exposure that is subject to credit protection may be adjusted in accordance with:
- (a) for credit derivatives, [the relevant instrument for

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23 Refer Attachment C of AGN 112.1.

*Standardised Approach to Credit Risk: Treatment of Credit Derivatives in the Banking Book*];

- (b) for guarantees, Attachment C to AGN 112.3; and
  - (c) for eligible collateral, Attachment A to AGN 112.4.
15. Where an ADI provides protection to an unrated credit enhancement, it must hold regulatory capital as if it were directly holding the unrated credit enhancement.

## Attachment D

### Internal ratings-based approach

#### *Maximum capital requirement*

1. Where an ADI uses the IRB approach to securitisation, the maximum regulatory capital requirement for the securitisation exposures it holds for each securitisation is the capital requirement that would have been determined for the underlying exposures had they not been securitised. For the purpose of this calculation, the regulatory capital charge for the pool before securitisation must be determined according to APS 113 including AGN 113.6. In addition, an ADI must deduct from Tier 1 capital the entire amount of any gain-on-sale from a securitisation.

#### *Hierarchy of IRB approaches*

2. Under the IRB approach to securitisation, there is a hierarchy of approaches that an ADI must follow to determine the regulatory capital charge for securitisation exposures as follows:
  - (a) where a securitisation exposure is externally rated, or where an external rating can be inferred, the ADI must use the ratings-based approach (**RBA**) as detailed in paragraphs 3 to 9;
  - (b) for facilities (such as liquidity facilities and credit enhancements) that the ADI extends to an ABCP securitisation and where the RBA approach cannot be used, the ADI may, subject to APRA's approval, use the internal assessment approach (**IAA**). In that event, the IAA must be used for all exposures that qualify for its use. In addition, the ADI must ensure that all the conditions detailed in paragraphs 10 to 13 are satisfied;
  - (c) for facilities where the ADI cannot use the RBA or IAA and all other securitisation exposures where the RBA approach cannot be used, the supervisory formula (**SF**), as detailed in paragraphs 14 to 35, may be applied (unless the ADI cannot use the SF because the ADI is unable to reliably determine  $K_{IRB}$ );
  - (d) for an eligible facility to which none of the approaches detailed in sub-paragraphs 2 (a) to (c) above can be applied, the ADI may apply, subject to written approval from APRA, the approach detailed in paragraph 37; and
  - (e) for a securitisation exposure to which none of the approaches detailed in sub-paragraphs 2 (a) to (d) can be applied, the exposure must be deducted from the ADI's

regulatory capital.

*Ratings-based approach*

3. As detailed in Attachment B, the risk-weighted asset amount of a securitisation exposure must be calculated by multiplying the exposure value, or in the case of an off-balance sheet exposure, the credit equivalent amount, by the relevant risk-weight.
4. The relevant risk-weight under the RBA depends upon:
  - (a) the external rating grade assigned to the securitisation exposure by an eligible ECAI or an inferred rating (as detailed in paragraphs 8 to 9);
  - (b) whether the rating (external or inferred) represents a long-or short-term rating;
  - (c) the granularity of the pool (as detailed in paragraph 7); and
  - (d) the seniority of the securitisation exposure.
5. Subject to paragraph 4, an ADI must apply the risk-weights in the following table when:
  - (a) an external credit assessment exists in the form of a long-term rating;
  - (b) an inferred rating based on an external long-term rating is available; or
  - (c) an internal assessment has been mapped to an external long-term rating as detailed in paragraph 10.

External Rating Grade	External credit assessment			Risk-weights for the most senior positions and eligible senior IAA exposures Column A	Base risk-weights Column B	Risk-weights for tranches backed by non-granular pools Column C
	Standard & Poor's Corporation	Moody's Investor Services	Fitch Ratings			
1	AAA AA+	Aaa Aa1	AAA AA+	7%	12%	20%
2	AA AA-	Aa2 Aa3	AA AA-	8%	15%	25%
3	A+	A1	A+	10%	18%	35%
4	A	A2	A	12%	20%	
5	A-	A3	A-	20%	35%	
6	BBB+	Baa1	BBB+	35%	50%	
7	BBB	Baa2	BBB	60%	75%	
8	BBB-	Baa3	BBB-	100%		
9	BB+	Ba1	BB+	250%		
10	BB	Ba2	BB	425%		
11	BB-	Ba3	BB-	650%		
12	Below BB- and unrated	Below Ba3 and unrated	Below BB- and unrated	Deduction from capital		

6. Subject to paragraph 4, an ADI must apply the risk-weights in the following table when:
- (a) an external credit assessment exists in the form of a short-term rating; or
  - (b) an inferred rating based on an external short-term rating is available.

External rating grade <sup>24</sup>	Risk-weights for senior positions Column A	Base risk-weights Column B	Risk-weights for tranches backed by non-granular pools Column C
1	7%	12%	20%
2	12%	20%	35%
3	60%	75%	75%
4/unrated	Deduction from capital	Deduction from capital	Deduction from capital

7. An ADI must apply the risk-weights in paragraphs 5 and 6 based on the effective number of underlying exposures (N, as defined in paragraphs 23 to 25) in a pool as follows:
- (a) if the effective number of underlying exposures is six or more and the position is the most senior exposure<sup>25</sup> in the securitisation, the ADI may apply the appropriate risk-weights detailed in column A;
  - (b) if the effective number of underlying exposures is less than six, the ADI must apply the appropriate risk-weights detailed in column C; and
  - (c) in all other cases, the ADI must apply the appropriate risk-weights in column B.

### *Inferred ratings*

8. Where the operational requirements detailed in paragraph 9 are met, an ADI may attribute an inferred rating to an unrated securitisation exposure. When assigning an inferred rating, the unrated exposure must be senior in all respects to an externally rated securitisation exposure called **the reference securitisation exposure**.
9. The following operational requirements must be satisfied for an ADI to recognise an inferred rating under the RBA:

24 Refer Attachment C of AGN 112.1 for short-term external rating grades for rated counterparties and exposures.

25 A securitisation exposure is treated as a senior tranche if it is effectively secured by a first claim on the entire amount of the exposures in the pool. For this purpose, the ADI does not have to take into consideration amounts due under interest rate swaps, currency swaps or eligible servicer cash advances.

- (a) the reference securitisation exposure from which the rating will be inferred must be a securitisation exposure from the same securitisation and be subordinate in all respects to the unrated securitisation exposure. Credit enhancements, if any, must be taken into account when assessing the relative subordination of the unrated securitisation exposure and the reference securitisation exposure;<sup>26</sup>
- (b) the maturity of the reference securitisation exposure must be equal to or longer than that of the unrated exposure;
- (c) an inferred rating must be continuously updated to reflect any changes in the external credit assessment of the reference securitisation exposure; and
- (d) the external credit assessment of the reference securitisation exposure must satisfy the operational requirements for such assessments as detailed in Attachment B.

**[ASF Note: One of the operational requirements in paragraph 9 is that the reference to securitisation exposure from which the rating will be inferred must be a securitisation exposure from the same securitisation and be subordinate in all respects to the unrated securitisation exposure. We note this requirement also exists under the Basel II Framework.]**

**However, if the unrated exposure ranks at least equally with the rated exposure, on one argument it should receive the same inferred rating as the rated exposure. In giving the rated exposure its rating, the rating agencies have taken into account all other exposures which rank equally or ahead of it. The ASF considers, therefore, that requiring subordination of any rated exposure is unnecessarily strict. We are not sure how, for instance, the rating agencies will treat transactions where ADI exposures are always senior rather than ranking equally with the most senior rated note exposure.]**

#### *Internal assessment approach*

- 10. Subject to written approval from APRA, an ADI may map its internal assessment of the credit quality of liquidity facilities, credit enhancements or other facilities that it has extended to an ABCP securitisation to equivalent external ratings of an eligible ECAI. The mapped ratings may then be used to determine the relevant risk-weight for the exposure as detailed in paragraphs 4 to 7.
- 11. Prior to using the IAA to determine the relevant risk-weight for a securitisation exposure, an ADI must ensure that:
  - (a) the ABCP securitisation is (or its securities are) externally

<sup>26</sup> Where the reference securitisation exposure benefits from any third-party guarantees or other credit enhancements that are not available to the unrated exposure, the unrated exposure cannot be assigned an inferred rating based on that reference securitisation exposure.

rated by an eligible ECAI;

- (b) the external credit assessment complies with the criteria detailed in Attachments B and C of AGN 112.1;
- (c) the internal assessment of the credit quality of a securitisation exposure to an ABCP securitisation is based on the rating criteria of an eligible ECAI for the exposure type in the pool and is at least grade 8<sup>27</sup> or above when initially assigned to the exposure;
- (d) if there are changes in the methodology of one of the eligible ECAIs that adversely affect the external credit assessment of the ABCP securitisation, then the revised rating methodology must be considered when revising the internal assessments;
- (e) the internal assessment is used in the ADI's internal risk management process, including management information and economic capital calculations, and meets all relevant requirements of APS 113;
- (f) the internal assessment methodology used by the ADI is fully documented and reflects the publicly available methodologies of all eligible ECAIs that rate ABCP securitisations for the securitised exposure type. In particular, the stress factors for determining credit enhancement requirements must be at least as conservative as the publicly available rating criteria of those eligible ECAIs;

**[ASF Note: The ASF requests APRA to provide guidelines for its expectations in relation to this paragraph and in particular, the required stress factors.]**

- (g) internal or external auditors, the eligible ECAI or the ADI's risk management area perform annual reviews of the internal assessment process and assess the validity of the internal assessments. The party performing the reviews of the internal assessment process must be independent from the ABCP business line and underlying customer relationships within the ADI; and
  - (h) the performance of internal assessments is monitored and reviewed on a regular basis to evaluate the performance of the assigned internal assessments. Adjustments to the assessment process must be made when the performance of the exposures diverges from the assigned internal assessments.
12. In order to use the IAA, an ADI must ensure that the ABCP securitisation:
- (a) has underwriting standards in the form of credit and investment

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27 Refer paragraph 5.

guidelines and performs a comprehensive credit analysis of the exposure risk profile;

- (b) has underwriting standards that establish minimum asset eligibility criteria that:
- (i) exclude the purchase of exposures that are past due or defaulted;

[ASF Note: The ASF submits that the requirement for underwriting criteria to “exclude the purchase of exposures that are past due.....”. is somewhat harsh and would mean that the IAA would not be able to be used for most ABCP securitisations. It is usual for ABCP conduits to be permitted to acquire assets where a payment is up to 30 days in arrears because these arrears usually “cure” and do not go on to default. The ASF therefore submits that the words “past due” should be deleted. The ASF also submits that the term “past due” can be confusing as there are a number of ways to measure arrears (for example, the scheduled payment method or missed payment method).]

- (ii) limit excess concentration to an individual obligor or geographic area; and
- (iii) limit the tenor of the exposures to be purchased;
- (c) has collections policies and processes that take account of the operational capability and credit quality of the servicing ADI;
- (d) when calculating the aggregate estimate of loss on the pool that the ABCP securitisation is considering purchasing, takes into account all sources of potential risk;

[ASF Note: The ASF submits that paragraphs 12(d) and (e) may be difficult to comply with where the ADI is not closely involved in the transaction (i.e. is not the seller/ sponsoring ADI). In addition, where the notes have been rated the ratings agency will have performed the risk assessments required for (d) and (e) and, the ASF submits that, if this risk assessment is sufficient to be relied upon in relation to the rated notes (which are risk-weighted purely based on their rating) it should be sufficient for the unrated facilities under the structure.]

- (e) incorporates structural features into the purchase of exposures in order to mitigate potential credit deterioration of the underlying portfolio; and

[ASF Note: Please see our comments in relation to paragraph 12(d) above.]

- (f) performs a comprehensive credit analysis of the seller’s risk

profile.

13. Where an ADI's internal assessment process no longer satisfies the requirements of paragraphs 11 and 12, APRA may (in writing) prohibit the ADI from applying the IAA to its ABCP exposures, both existing and newly originated, for the purpose of determining the appropriate regulatory capital treatment. Where this occurs, the ADI may use the SF or, where the SF cannot be used, the method detailed in paragraph 37.

#### *Supervisory formula*

14. When using the SF, the regulatory capital charge for a securitisation exposure depends upon the following ADI-supplied inputs:
  - (a) the IRB capital requirement had the pool not been securitised (**K<sub>IRB</sub>**);
  - (b) the credit enhancement level (**L**);
  - (c) the thickness (**T**);
  - (d) the effective number of exposures in the pool (**N**); and
  - (e) the pool's exposure-weighted average loss-given-default (**LGD**)

#### *Definition of K<sub>IRB</sub>*

15. **K<sub>IRB</sub>** is the ratio (in decimal form) of:
  - (a) the IRB capital requirement (as determined by APS 113), including the expected loss portion, for the pool; to
  - (b) the exposure amount of the pool, i.e. the sum of drawn amounts plus the estimated exposure at default of undrawn commitments.
16. The amount in paragraph 15(a) above must be calculated in accordance with the applicable minimum IRB standards (as detailed in APS 113) as if the exposures in the pool were held directly by the ADI. This calculation may reflect the effects of any credit risk mitigant that is applied on the underlying exposures in the pool (either individually or to the entire pool).
17. For structures involving an SPV, all the assets of the SPV that are related to the securitisation must be treated as exposures in the pool for the purposes of paragraph 15, including assets in which the SPV may have invested a reserve account.

#### *Definition of the credit enhancement level (L)*

18. **L** is measured (in decimal form) as the ratio of:

- (a) the ~~outstanding amount~~ EAD of all securitisation exposures subordinate to the securitisation exposure; to
- (b) the sum of the exposure values of the exposures that have been securitised (i.e. the EAD of the underlying exposures that have been securitised).

**[ASF Note: These amendments are made for clarification and to ensure that the definitions used for the credit enhancement level (L) and thickness of exposure (T) are consistent.]**

- 19. An ADI must determine L before considering the effects of any tranche-specific credit enhancements that benefit only a single tranche. Any gain-on-sale associated with the securitisation must not be included in the measurement of L. The size of interest rate or currency swaps that are more junior than the tranche may be measured at their current mark-to market-value (i.e. excluding the amount estimated for potential future exposure) when calculating L. If the mark-to-market value cannot be measured, the derivative instrument must be ignored in the calculation of L.
- 20. Unfunded reserve accounts must not be included in the calculation of L if they are to be funded from future receipts from the underlying exposures. If there is any reserve account that has already been funded by accumulated cash flows from the underlying exposures that is more junior than the tranche in question, then it may be included in the calculation of L.

*Definition of the thickness of exposure (T)*

- 21. T is measured as the ratio (in decimal form) of:
  - (a) the ~~nominal size~~ EAD of the securitisation exposure; to
  - (b) the sum of the exposure values of the exposures that have been securitised (i.e. the EAD of the underlying exposures that have been securitised).

**[ASF Note: Please see our comments in relation to paragraph 18 above.]**

- 22. Where an exposure arises from an interest rate or currency swap, an ADI must incorporate the potential future exposure of the swap in the measurement of the nominal size of the securitisation exposure in paragraph 21 (a). If the mark-to market value of the derivative instrument is positive, the exposure size must be measured by the **current exposure method** as detailed in Attachment B to AGN 112.2. If the mark-to-market value of the derivative instrument is negative, the exposure must be measured by using the potential future exposure only.

*Definition of the effective number of exposures (N)*

23. N is calculated as:

$$N = \frac{(\sum_i EAD_i)^2}{\sum_i EAD_i^2}$$

where EAD<sub>i</sub> represents the exposure at default associated with the i<sup>th</sup> exposure in the pool.

24. Multiple exposures to the same obligor must be consolidated when calculating the effective number of exposures in paragraph 23.
25. In the case of securitisation of securitisation exposures (**re-securitisation**), the formula in paragraph 23 applies to the number of securitisation exposures in the pool and not the number of underlying exposures in the original pools. If the portfolio share associated with the largest exposure (C1) is available, an ADI may compute N as 1/C1.

*Definition of the exposure-weighted average loss given default*

26. LGD is calculated as follows:

$$LGD = \frac{\sum_i LGD_i \cdot EAD_i}{\sum_i EAD_i}$$

where LGD<sub>i</sub> represents the average LGD associated with all exposures to the i<sup>th</sup> obligor.

27. In the case of re-securitisation, an LGD of 100 per cent must be assumed for the underlying securitised exposures. When default and dilution risks for purchased receivables are treated in an aggregate manner within a securitisation, the LGD input must be constructed as a weighted average of the LGD for default risk and 100 per cent LGD for dilution risk. The weights to be used in this calculation are the stand-alone IRB regulatory capital requirements for default risk and dilution risk, respectively (as determined by APS 113).

Capital charge under the supervisory formula

28. The capital charge under the SF is calculated as the securitisation exposure—amount of the exposures which have been securitised multiplied by the greater of:
- 0.0056\*T; and
  - (S [L+T] - S [L])

where the function S[.] (the **supervisory formula**) is defined in paragraph 30.

[ASF Note: This amendment is designed to accord with Paragraph 623 of the Basel II November 2005 Accord which

refers to the “amount of the exposures that have been securitised”. The current reference in this paragraph 28 to “securitisation exposures” refers to the defined term in paragraph 5(f). This does not appear to be correct and would result in the risk weighted amount being incorrectly calculated.]

29. When the ADI holds only a proportional interest in the securitisation exposure, that position’s capital charge equals the pro rated share of the regulatory capital requirement of the entire securitisation exposure.
30. The supervisory formula is given by the following expression:

$$S[L] = \left\{ \begin{array}{l} L \\ K_{IRB} + K[L] - K[K_{IRB}] + (d \cdot K_{IRB} / \varpi)(1 - e^{\varpi(K_{IRB} - L)/K_{IRB}}) \end{array} \right\} \begin{array}{l} \text{when } L \leq K_{IRB} \\ \text{when } K_{IRB} < L \end{array}$$

where:

$$\varpi = 20$$

$$h = (1 - K_{IRB} / LGD)^N$$

$$c = K_{IRB} / (1 - h)$$

$$v = \frac{(LGD - K_{IRB})K_{IRB} + 0.25(1 - LGD)K_{IRB}}{N}$$

$$f = \left( \frac{v + K_{IRB}^2}{1 - h} - c^2 \right) + \frac{(1 - K_{IRB})K_{IRB} - v}{(1 - h)1000}$$

$$g = \frac{(1 - c)c}{f} - 1$$

$$a = g.c$$

$$b = g.(1 - c)$$

$$d = 1 - (1 - h).(1 - \text{Beta}[K_{IRB}; a, b])$$

$$K[L] = (1 - h).(1 - \text{Beta}[L; a, b])L + \text{Beta}[L; a + 1, b]c$$

Beta [L; a, b] refers to the cumulative beta distribution with parameters and be valuated at L.

[ASF Note: The ASF submits that the RWA calculation for the Supervising Formula is quite technical and not easy to follow. The ASF notes that the FSA has provided worked examples on how the Supervisory Formula is to be applied including a section titled “Frequently Asked Questions”. The ASF requests that APRA also publishes worked examples that can be used as guidance by Australian ADIs.]

31. Risk-weighted asset amounts generated through the use of the SF are

calculated by multiplying the regulatory capital requirement (as determined in paragraph 30) by 12.5. If the risk-weight resulting from the SF is 1250 per cent or greater, an ADI must deduct the securitisation exposure from its capital.

32. In the case where an ADI has set aside a specific provision or has a non-refundable purchase price discount on an exposure in the pool,  $K_{IRB}$  and  $L$  must be calculated using the gross amount of the exposure without taking into account the specific provision and/or non-refundable purchase price discount. In this case, the amount of the non-refundable purchase price discount on a defaulted asset or the specific provision can be used to reduce the amount of any deduction from capital associated with the securitisation exposure.

*Simplified method for determining the effective number of exposures and the exposure-weighted average loss given default*

33. Subject to written approval from APRA, an ADI that has a securitisation involving retail exposures (refer APS 113) may use a simplified method for calculating the effective number of exposures ( $N$  in the expression in paragraph 30) and the exposure-weighted average LGD (LGD in the expression in paragraph 30) whereby the SF may be implemented using the simplifications  $h = 0$  and  $v = 0$ .
34. Under the simplified method, if the portfolio share associated with the largest exposure ( $C_1$ ) is no more than 3 per cent of the underlying pool, then for purposes of the SF, an ADI may set LGD equal to 50 per cent and  $N$  equal to the following amount:

$$N = \left( C_1 C_m + \left( \frac{C_m - C_1}{m - 1} \right) \max \{1 - m C_1, 0\} \right)^{-1}$$

where  $C_m$  denotes the share of the securitised asset pool corresponding to the sum of the largest  $m$  exposures. The level of  $m$  is decided by the ADI.

35. Alternatively, if only  $C_1$  is available and this amount is no more than 3 per cent, then the ADI may set LGD equal to 50 per cent and  $N=1/C_1$ .

*Eligible facilities*

36. Under the IRB approach, eligible facilities (as detailed in Attachment E) receive a CCF of 100 per cent except as provided in paragraph 37.

**[ASF Note: Given the difficulty for funding facilities in particular to comply with the requirements for an “eligible facility” (see comments on paragraph 14 of Attachment E) the ASF submits that there will be circumstances in which this paragraph does not apply. The ASF queries what CCF will apply if a facility is not an “eligible facility”?]**

37. Where an ADI is not able to reliably determine  $K_{irb}$ , and hence cannot

use the SF to determine the regulatory capital charge for eligible facilities, the ADI may temporarily, subject to written approval from APRA (which may specify the period during which the approval applies), determine the regulatory capital charge for such facilities as follows:

- (a) in calculating the credit equivalent amount, use a 50 per cent CCF for a facility with an original maturity of up to one year or a 100 per cent for a facility with an original maturity of more than one year; and
- (b) risk-weight the credit equivalent amount using the highest risk-weight (as determined by APS 112) applicable to any individual exposure in the pool covered by the facility.

#### *Eligible servicer cash advance*

38. An ADI may apply a 0 per cent CCF to an undrawn eligible servicer cash advance that meets the requirements of Attachment E.

**[ASF Note: Given the difficulties in complying with the requirements for an “eligible servicer cash advance” (see comments on paragraph 16 of Attachment E), the ASF queries what CCF will apply if a facility is not an “eligible servicer cash advance”?]**

#### *Treatment of credit risk mitigation for securitisation exposures*

39. Under the RBA and when using the SF, an ADI may apply the credit risk mitigation techniques as detailed in the foundation IRB approach (refer *Guidance Note AGN 113.2 Internal Ratings-based Approach to Credit Risk Corporate, Sovereign and Bank Asset Classes*). The ADI may proportionately reduce the regulatory capital charge for a securitisation exposure when the credit risk mitigation covers first losses or losses on a proportional basis. For all other cases, the ADI must assume that the credit risk mitigation covers the most senior portion of the securitisation exposure.

## Attachment E

### Facilities and services

1. Facilities that are provided by an ADI to a securitisation must comply with the following requirements:

- (a) the extent of the facility provided by the ADI to an SPV must be expressly stated in a written agreement. There must be no explicit or implied recourse to the ADI beyond the specified contractual obligations;
- (b) the ADI is able to demonstrate that the facility is provided on an arm's length basis, is subject to the ADI's normal credit approval and review processes and is transacted on market terms and conditions (including price or fee), except for pre-existing derivative transactions relating to the underlying exposures;

[ASF Note: We believe that this change is necessary since with fixed rate swaps that have fixed prior to the securitisation, it would not be possible to satisfy this requirement.]

- (c) the facility is limited to a specified amount<sup>28</sup> and time period. A fixed termination date need not be specified, provided the facility extinguishes at the earliest of the scheduled maturity of the securitisation or the date on which the securitisation winds up. Where the facility is not limited to a fixed time period, the ~~The~~ ADI must be able, at its absolute discretion, to withdraw from its commitments at any time following a reasonable period of notice of no more than 90 days. ~~The ability to withdraw must not be conditional upon the appointment of an alternative facility provider;~~

[ASF Note: We note that paragraph (c) will now apply to facilities generally provided by an ADI to a securitisation, which will include liquidity and funding facilities and derivatives with an SPV. In the current APS120 (May 2006), this requirement was limited to servicing and managing roles only (see AGN 120.5, paragraphs 7(c) and 11). It is submitted that the consequence of this requirement in relation to liquidity and funding facilities and derivatives will be to require ADIs who provide them to cash collateralise their obligations under these facilities in circumstances where they are not limited to a fixed time period. This is because the ratings agencies have indicated that they would not be in a position to rate a securitisation where the service provider for these facilities can retire or withdraw without a mechanism to replace that service provider. We submit that the final sentence of paragraph (c) should be limited to servicing ADIs and managing ADIs as

28 A derivative transaction can be an undetermined amount provided the contract fixes a maximum principal amount.

currently contemplated in paragraph 23(d) and should not be extended to all other facilities provided by ADIs.]

- (d) ~~the SPV has the express right to select an alternative party to provide the facility; and~~ [Not used]

[ASF Note: We do not consider that an SPV should have an unfettered right to remove an ADI from providing a facility where that facility has been negotiated on arm's length terms. It is usual for the facility provider to only be removed where it is in default of its obligations under the facility. We believe that this concept should be retained.]

- (e) the facility is documented in a manner that clearly separates it from any other facility or service provided by the ADI. The ADI's obligations under each facility must stand alone.
2. Liquidity, underwriting and funding facilities will be considered eligible facilities<sup>29</sup> where the requirements of this Attachment are met.

#### *Spread accounts*

3. Where an ADI transfers a pool to an SPV, it may be entitled to future surplus income generated by a securitisation. These arrangements may, among others, take the form of a deferred purchase price, excess servicing income, gain on sale, residual interest, excess spread<sup>30</sup> or similar arrangements.

[ASF Note: There is an inconsistency in paragraphs 3, 4 and 5 of Attachment E, where "ADI" is used in paragraphs 3 and 4 and "originating ADIs" is used in paragraph 5.]

4. An ADI must deduct from its Tier 1 capital (refer APS 111) any expected future income from a securitisation exposure that it has reported as an on-balance sheet asset. This means that where an ADI provides funds to establish a spread, reserve or similar account, those amounts must be deducted from its Tier 1 capital until the funds are irrevocably paid to the ADI. Similarly, where an ADI transfers exposures to an SPV below their book value (e.g. pursuant to an overcollateralisation agreement or by sale at a discounted price), the difference between the book value and the amount received by the ADI must be deducted from its Tier 1 capital unless it is written off in the ADI's profit and loss account.

[ASF Note: Please see our comments in relation to paragraph 3 above. Further we note that this paragraph appears to be inconsistent with the requirements of the Basel II Framework where a

<sup>29</sup> An ADI must determine whether a facility is an eligible facility for the purposes of paragraphs 5, 11 and 12 of Attachment C and paragraphs 2, 36 and 37 of Attachment D.

<sup>30</sup> Excess spread is defined as finance charge collections and other fee income received by the SPV net of costs, interest and expenses.

deduction is require to be made, 50% from Tier 1 capital and 50 % from Tier 2 capital. Accordingly we request that this paragraph be amended to reflect the Basel II Framework in this regard.]

5. An originating ADI may be entitled to capital relief in accordance with paragraph 2 or 3 of Attachment B where it is entitled to receive future surplus ~~neome~~income generated by a securitisation where the ADI:
  - (a) makes no payment to the SPV in exchange for an income stream or, where the ADI does make a payment, that payment is written off in the ADI's profit and loss (and capital) accounts;
  - (b) has no right, and is under no obligation as a result of its entitlement to receive fees or other income, to repurchase any non-performing exposures from the pool, or otherwise cover losses on exposures in the pool or losses of investors;
  - (c) is under no obligation to return any fees or income once received; and
  - (d) does not recognise, for profit and loss (and capital) purposes, such fees or income until irrevocably received.

[ASF Note: Please see our comments in relation to paragraphs 3 and 4 above.]

#### *Underwriting of an SPV*

6. In addition to the requirements detailed in paragraph 1, an ADI providing an underwriting facility to a securitisation must ensure that:
  - (a) the ADI's acquisition of securities pursuant to the underwriting facility is exercisable only when an issuer cannot issue securities into the market at a price equal to (or above) the predetermined benchmark detailed in the underwriting agreement;
  - (b) the ADI has the ability to withhold payment and to terminate the facility, if necessary, upon the occurrence of specified events; and
  - (c) a market exists for the type of underwritten securities.
7. An ADI that acts as the sole underwriter for the initial issue of securities by an SPV may keep or acquire up to 100 per cent of the initial issue on commencement of the securitisation. An ADI must limit its risk exposure from its underwriting of a particular securitisation so that it is not material relative to the ADI's credit risk-weighted assets and capital.

8. An ADI may only participate in a revolving underwriting facility, or an underwriting facility covering the subsequent issues of securities by an SPV, if:
  - (a) it complies with paragraph 1 of this Attachment; and
  - (b) the ADI's commitment to take up securities cannot be triggered by the failure of the SPV to meet its obligations, other than where such failure results from an inability to roll-over securities due to adverse market conditions.

#### *Funding of an SPV*

9. Subject to paragraph 10, in addition to the requirements detailed in paragraph 1 above, an ADI that provides a funding facility to an SPV must ensure that:
  - (a) any draw-down of the funding facility incorporates a specified maturity date;
  - (b) the funding facility does not fund more than 20 per cent of the pool of the SPV at any time during the life of the securitisation, unless written approval from APRA is obtained;

[ASF Note: The ASF would like to see it clarified that this requirement does not relate to the provision of a liquidity facility used to repay commercial paper. Liquidity facilities used for this purpose typically require the funding available under them to be up to 100% of the pool. In addition, the ASF would like to clarify that this limitation should not apply to a warehouse facility, which is described in paragraph 10. The ASF's view is that all of paragraph 9 should be made subject to paragraph 10. Further, in paragraph 9(b) an ADI providing a funding facility is required to ensure that the limit is 20%. This applies to any ADI and is not limited to the ADI that originated the assets. The ASF queries the reasoning for limiting funding to an SPV to 20% (particularly where the funding is provided on an arms length basis by an ADI that is not the sponsor or seller of the securitisation program). The ASF notes that there is no percentage limitation imposed on an identical facility to a borrower who is not a securitisation vehicle and submits that (except possibly in the case of a funding to a securitisation vehicle from the ADI that originated the assets) should not be treated differently from funding to any other borrower.]

- (c) the funding facility is provided for:
  - (i) the purpose of acquiring additional (rather than the initial) exposures in the pool;
  - (ii) the refinancing of an existing loan used to fund the acquisition of additional exposures by the SPV; or

- (iii) redraws on existing exposures in the pool; and
  - (d) repayments of drawings under the facility rank senior or pari passu to the interests of investors.
10. An ADI may provide temporary funding to an SPV during the establishment phase of a securitisation to facilitate the acquisition of exposures in a pool pending the issue of securities where:
- (a) the ADI is only committed to fund the initial acquisition of exposures of the pool;
  - (b) there is no indication that any of the exposures in the pool to be acquired will not be repaid fully at the time the ADI is required to advance funding;

[ASF Note: The ASF again notes that this applies to any ADI and is not limited to the ADI that originated the assets. The ASF queries what is meant by the words “no indication that any of the exposures in the pool to be acquired will not be repaid fully...” In particular, the ASF queries whether the intended effect of this paragraph is that no arrears loans may be funded in a warehouse facility? The ASF notes that it is common in arms length warehouse facilities (particularly where the originator of the assets is a non ADI and therefore has no balance sheet) to allow loans that are up to 60 days in arrears to be funded. There are provisions in the structure such as excess spread and over collateralisation that are specifically sized to cover potential future losses and in the case of LMI insured mortgages the mortgage insurance is normally available to cover shortfalls on sale of an asset. In those cases this requirement would appear to be unnecessary. The ASF submits that the requirement should be removed, or at the least limited to an ADI who originated the assets that are being funded by it.]

- (c) the ADI is fully secured against any funding provided;
- (d) drawings under the facility will be repaid as soon as the SPV receives the funds from the sale of the securities; and
- (e) the ADI has in place adequate systems and controls to ensure that it does not accumulate disproportionate levels of aggregate exposure (relative to the ADI’s credit risk-weighted assets and capital) to SPVs.

#### *Derivative transactions*

11. In addition to the requirements detailed in paragraph 1 above, an ADI may enter into derivative transactions with an SPV where:
- (a) transactions that involve mismatches of more than 90 days between the payment by the ADI and subsequent receipt from

the SPV have received written approval from APRA;

[ASF Note: This requirement does not take into account whether the mismatch is in the ADI's favour or whether the transaction is otherwise an arm's length transaction with the ADI receiving a 'spread' for the mismatch. The ASF notes that, where an SPV issues fixed rate notes with a 6 monthly coupon, it is common for a swap to be structured so that the ADI swap provider pays fixed once per 6 months but the SPV passes through floating every month. This is structured to minimise unnecessary negative carry on the floating rate funds. These transactions are done on an arms length basis and the ADI is rewarded for this mismatch through an increased swap spread. The ASF further notes that there is no requirement for an ADI to obtain written approval from APRA where a transaction on this basis is entered into with a counterparty other than a securitisation vehicle and submits that a transaction with a securitisation SPV should not be treated any differently (particularly where the swap is provided on an arms length basis by an ADI that is not the originator of the assets). The ASF submits that requirement to obtain APRA approval will be time consuming and cumbersome and notes that there are no grounds set out for when approval will be granted. The ASF believes that potential uncertainty regarding the approval process could prevent domestic ADIs from writing this type of business in future, but in the circumstances where a transaction is at arms length and the requirements of attachment B and E are otherwise met appears to afford no additional protection to an ADI or its deposition.]

- (b) the transactions do not involve the acquisition by the ADI of securities issued by the SPV or exposures from the pool held by the SPV (including a beneficial interest) except where the conditions in Attachment F are satisfied; and
  - (c) the ADI has satisfied itself that the counterparty has the power to undertake the transaction and the counterparty is aware of the risks that it might face from the transaction.
12. In addition to the requirements of paragraph 11, an ADI entering into a basis swap with an SPV must ensure, and be able to demonstrate to APRA, that the basis swap is constructed with sufficient margin so that the ADI is not expected to be a net payer during the life of the transaction.
13. Where the ADI is, or expects to be, a net payer in a derivative transaction for significant periods,<sup>31</sup> the ADI must report to APRA those transactions:

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31 For swaps with monthly settlements, APRA considers three or more consecutive months on an aggregate of six months over any rolling 12 month period significant. For swaps with quarterly settlements, a significant period will be three consecutive quarters or an aggregate of four quarters in any rolling 24 month period.

- (a) that are not in accordance with sub-paragraph 1 (b); and/or
- (b) where the transaction covers an undetermined amount, as defined in paragraph 1 (c).

*Eligible facilities*

14. For the purposes of this Prudential Standard, a liquidity, underwriting or funding facility will be an **eligible facility** where:

- (a) the facility documentation clearly identifies and limits the circumstances under which it may be drawn;
- (b) draw-downs under the facility are limited to the amount that is likely to be fully repaid from the liquidation of the underlying exposures and any credit enhancements provided by parties other than the ADI;

[ASF Note: The ASF is concerned that the words “likely to be fully repaid” are uncertain. Given the importance of this requirement in determining whether a facility is eligible or not, it is requested that APRA provide greater certainty and guidance in relation to this concept.]

- (c) the facility does not cover any losses incurred in a pool prior to a drawdown under the facility or it is not structured such that draw-down is certain (as indicated by regular or continuous draws);

[ASF Note: The ASF submits that the requirement that a facility is not “structured such that drawdown is certain” is not commercially viable as the whole purpose of a funding facility is to enable regular and continuous drawings provided any conditions precedent specified in the relevant document are met. In addition, the purpose of an SPV acquiring a liquidity or underwriting facility, is so that drawdowns can be made as a matter of certainty, provided the necessary conditions precedent are met. The underwriting or liquidity facility would not otherwise be acceptable to external ratings agencies or investors. The ASF submits that the inclusion of these requirements will mean that most facilities offered by ADIs will either be not commercially viable or acceptable to external ratings agencies and investors, or unable to be treated as “eligible facilities”. Both of these have serious consequences to the ADI’s potential to write future business of this nature.]

- (d) the facility is limited as follows:
  - (i) for externally rated exposures, the facility includes a provision that it can only be used to fund exposures that, at the time of funding, are externally rated grade 8 or above (refer paragraph 5 of Attachment D) for the IRB approach or grade 3 or above (refer paragraph 3 of

Attachment C) for the standardised approach. Where the rating of the underlying exposures deteriorates to below grade 8 or 3, as relevant, there must be an automatic reduction in the amount of the facility by the amount of the exposures which have been downgraded; or

[ASF Note: For example, if a liquidity facility relates to liquidity provided in respect of the repackaging of long term assets with commercial paper, the reference to the “underlying exposure” seems to mean that the ADI would have to treat a “BBB-” exposure of the SPV as a defaulted asset. The ASF views the operation of this requirement as potentially unduly harsh. This conclusion is emphasised, given the requirement in paragraph 14(d)(ii) which permits unrated exposures to be funded against provided they are “non defaulted”. The ASF requests APRA’s reconsideration of this requirement.]

The effect of this requirement also appears to be that a facility over a whole pool of assets effectively can not be an “eligible facility” where any of the notes issued by the SPV are externally rated below BBB- or A3/P3/F3 short term. This means for example, that a swap with an SPV, for the full face value of assets in a pool will not be an “eligible facility” if any of the notes are rated sub investment grade. The ASF submits that this is not commercially viable and will not be acceptable to ratings agencies or investors. This provision will cause serious implications for ADI's future business and the ASF notes does not apply to facilities to counterparties other than securitisation vehicles. The ASF queries the necessity for it and submits that it should be deleted.]

- (ii) for unrated exposures, the facility includes a provision that it can only be used to fund non-defaulted exposures. Where underlying exposures default, there must be an automatic reduction in the amount of the facility by the amount of defaulted exposures;

[ASF Note: The ASF notes that the requirement that the facility limit can not include “defaulted exposures” would impose a requirement that the facility limit automatically reduces to the extent there has been a default under an asset in the pool of assets. Again, this is not commercially viable and would not be acceptable to investors. Why must this be the case where the facility is for only a portion of the exposure (say 20%)? If the losses equal \$10, (so there is \$90 of assets), why should the facility reduce by \$10? The ASF again submits that no such requirement appears to exist for facilities to non securitisation counterparties and submits that it should be deleted.]

The ASF also queries whether this provision is intended to apply where part of an exposure is unrated i.e. there is a first loss piece that is unrated although all the tranches above have eligible external ratings does this paragraph apply? If so how is it intended to be apportioned? Does it only apply to the extent of the first loss piece?

- (e) the facility cannot be drawn after all applicable (e.g. transaction-specific or program-wide) credit enhancements from which the facility would benefit have been exhausted;

[ASF Note: This effectively requires that liquidity facilities and funding facilities cannot be drawn after all applicable credit enhancements from which the facility would benefit have been exhausted. The ASF views that this is unnecessary, because not all such facilities provide credit enhancement.. So long as the facility is not funding against defaulted assets, then the ASF's view is that it should not matter that credit enhancement has been exhausted, as the assets will be sufficient to back the repayment of the facility.]

- (f) repayments of draws on the facility are not subordinated to the claims of investors other than to claims arising in respect of interest rate or currency derivative contracts, fees or other such payments, nor are they subject to waiver or deferral; and
- (g) the facility meets the following conditions:
- (i) it satisfies the conditions in paragraph 1;
  - (ii) if it is an underwriting facility - paragraphs 6 to 8 are satisfied; and
  - (iii) if it is a funding facility - paragraphs 9 to 10 are satisfied.

15. Where drawings under an eligible facility remain outstanding after 90 days, an ADI must inform APRA of the nature of the advances and the reasons for non-repayment.

[ASF Note: The ASF submits that the requirement for drawings to be repaid within 90 days is not a commercially viable alternative, particularly for warehouse funding facilities, where the drawings can only really be repaid through a term issue. The very nature of the warehouse facility is to enable the SPV time to build up sufficient assets to do a term issue. This cannot usually be done in 90 days. Further, the ASF submits that this requirement would require an SPV sponsor to do a term issue every 90 days which is not practical in terms of timing or expense incurred. The sponsor of an SPV will want the flexibility to do a term issue when market conditions are right and may not want to undertake 4 issues a year (which this provision would effectively require). The ASF submits that the inclusion of this requirement will have serious consequences for an ADI's ability to write this business in the future and will have a flow

on effect to “non balance sheet” lenders who are very dependent on this form of funding and who provide a valuable service to the market. The ASF therefore submits that it should be deleted.]

*Eligible servicer cash advance*

16. A servicing ADI may recognise an eligible facility as an eligible servicer cash advance<sup>32</sup> where:
- (a) the servicing ADI advances cash to ensure an uninterrupted flow of payments to investors and the ADI is entitled to full reimbursement;
  - (b) repayments of drawings under the cash advance rank senior to all other claims on the cash flow from the pool; and

[ASF Note: We believe this needs clarification. What happens if taxes and trustee’s fees and expenses have priority (or receiver’s costs and expenses on enforcement?)

- (c) the facility is unconditionally cancellable without prior notice by the servicing ADI.

*Lending to investors*

17. An ADI may advance funds directly to investors for the purpose of investing in securities issued by an SPV.<sup>33</sup>
18. An ADI acting as a lender to investors must ensure that:
- (a) any undertaking provided to investors is expressly stated in a written agreement that makes clear that funding to investors is separate from any other facility or service provided by the ADI and that there is no recourse to the ADI beyond the specified contractual obligations;
  - (b) the ADI is able to demonstrate that the lending facility is:
    - (i) provided on an arm’s length basis;
    - (ii) subject to the ADI’s normal credit approval and review processes; and
    - (iii) transacted on market terms and conditions (including price or fee);
  - (c) the lending facility is limited to a specified amount and a specified time period. The termination date of the lending

32 An ADI needs to determine whether a facility is an eligible servicer cash advance for the purposes of sub-paragraph 5 (d) and paragraph 13 of Attachment C and paragraph 38 of Attachment D.

33 Such an advance must not be considered a funding facility for the purposes of this Prudential Standard.

facility need not be specified, provided the facility extinguishes at the earliest of the scheduled maturity of the securitisation or the date on which the securitisation winds up. ~~The ADI must have an unfettered discretion to withdraw from the lending facility at any time following a reasonable period of notice of no more than 90 days. The ADI's right to withdraw must not be conditional upon the appointment of an alternative lender;~~

**[ASF Note: It is submitted that this requirement for withdrawal from the facility is not commercially viable and does not reflect market practice for these facilities. Such a requirement would mean that investors would need to liquidate their securities in circumstances where such a facility could not be replaced or refinanced. An alternative may be to provide that the ADI must have an unfettered discretion to cancel any undrawn commitment, but again, if the facility is on arm's length terms and satisfies the requirements in paragraph (b), it is difficult to see any additional protections which such a requirement would provide to the ADI or its depositors.]**

- (d) any draw-down of the lending facility incorporates a specified maturity date;
- (e) there is no implication that the lending facility acts other than as a stand alone lending facility to the customer of the ADI; and
- (f) the ADI has full recourse to the investor beyond any collateral for repayment of advances and does not cover losses incurred by the investors.

### *Services*

- 19. An ADI may act as a service provider to a securitisation subject to paragraphs 20 to 27 below.
- 20. An ADI that provides services to a securitisation must ensure that its operational risk capital requirement, as determined by *Prudential Standard APS 114 Capital Adequacy: Standardised Approach to Operational Risk (APS 114)* or *Prudential Standard APS 115 Capital Adequacy: Advanced Measurement Approaches to Operational Risk (APS 115)*, as appropriate, adequately covers the operational risk of providing such services.
- 21. An ADI providing services to a securitisation must ensure that it does not subordinate, defer or waive the receipt of fees or other income for its role as a service provider. ~~Any deferral or waiving of fees or other income will be considered, by APRA, as implicit support (refer paragraph 22 of this Prudential Standard).~~

**[ASF Note: This provides that APRA will consider any performance fee which is deferred to the rated debt to be treated as "implicit support". The ASF's view is that a split fee approach of a base fee that ranks senior to the rated debt with a performance fee ranking junior to the**

rated debt should not be treated as implicit support. The junior performance fee creates an incentive for the ADI to service the assets efficiently leading to timely payment of principal and interest on the securities that are issued. The ASF's view is that this requirement should be removed. Please also see our comments in relation to paragraph 22 of APS 120 and to Paragraph 1 of Attachment A.]

*Offering advice and conducting brokerage business*

22. An ADI must ensure that where it conducts advisory and brokerage business that:
- (a) these activities are conducted with investors or the SPV on an arm's length basis and on market terms and conditions;
  - (b) the decision making rests with investors who are aware that they will bear all risks associated with the decision taken; and
  - (c) policies and procedures are in place to ensure that staff (and any agents of the ADI) dealing with investors are appropriately trained and avoid misleading or confusing them concerning the risks involved or the ADI's relationship with or support for the securities and products recommended or offered for sale.

*Servicing and managing*

23. An ADI may only undertake the role of servicing the pool held by an SPV or managing the securitisation where:
- (a) there is a formal written agreement in place which specifies the services to be provided and any required standards of performance. These standards must be reasonable and in accordance with normal market practice. There must be no recourse to the ADI beyond the fixed contractual obligations specified and the agreement must explicitly state that the ADI has no liability with regard to the performance of the pool;
  - (b) the agreement does not oblige the ADI to provide any other services;
  - (c) the ADI is able to demonstrate that the agreement is undertaken on an arm's length basis, on market terms and conditions (including remuneration) and is subject to the ADI's normal approval and review processes;
  - (d) the agreement is limited as to a fixed time period (which must be no later than the earlier of the date on which all claims connected with the issue of securities are paid out and the servicing ADI's or managing ADI's replacement as party to the agreement). However, a fixed termination date need not be specified provided the servicing ADI or managing ADI is able, at its absolute discretion, to withdraw from its commitments at any time following a reasonable period of notice of no more

than 90 days. Withdrawal must not be conditional upon the appointment of an alternative service ~~provide~~provider;

**[ASF Note: These amendments have been made to use the appropriate defined terms in paragraph 5 of the Prudential Standard.]**

- (e) subject to reasonable qualifying conditions, the SPV and/or investors have the express right during the lifetime of the securitisation to select an alternative party to provide the service (including where a specified servicer or manager (as the case may be) default has occurred);

**[ASF Note: It is unclear whether both the investors and the SPV must have this right. In any event, we do not consider that an SPV and/or investors should have an unfettered right to remove a servicing ADI or managing ADI where that servicing role or managing role has been negotiated on arm's length terms. It is usual for the service provider to only be removed where it is in default of its obligations under the relevant agreement. We believe that this concept should be retained. We believe the additional words which we have added will address this issue. We believe that these arrangements coupled with the ability of the ADI to retire on no more than 90 days' notice (see subparagraph (d) above) where the agreement is not for a fixed time period is all that is necessary to protect the ADI and SPV/investors.]**

- (f) the servicing or management agreement is documented such that this function is clearly separated from any other service or facility provided by the ADI. An ADI's obligations under each service and facility must be stand-alone; and
- (g) the ADI's operational systems are adequate to meet its obligations as a servicing ADI or managing ADI.

**[ASF Note: This amendment has been made to refer to the defined term in paragraph 5 of the Prudential Standard.]**

24. There must not be an obligation for a servicing ADI or managing ADI to remit funds to an SPV or investors until the funds are received from the pool, except where this is otherwise provided for in a separate facility (e.g. a liquidity facility).

**[ASF Note: This amendment has been made to refer to the defined term in paragraph 5 of the Prudential Standard.]**

25. An ADI may receive a performance-related payment (or benefit from any surplus income generated) for its role as a servicing ADI or managing ADI, in addition to its base fee, where the base fee is on market terms and conditions and any performance-related payment does not commit the servicing ADI or managing ADI to any additional obligations. Such payment must be recognised for profit

and loss (and capital) purposes only after it has been irrevocably received by the servicing ADI or managing ADI.

**[ASF Note: These amendments have been made to refer to the defined term in paragraph 5 of the Prudential Standard.]**

26. An ~~ADI~~ servicing ADI or managing ~~a securitisation ADI~~ must comply with APRA's separation and disclosure requirements detailed in Attachment A.

**[ASF Note: These amendments have been made to refer to the defined term in paragraph 5 of the Prudential Standard.]**

27. Where a servicing or management agreement does not meet the conditions above, the ADI ~~will~~ may be considered, by APRA, as providing implicit support to the securitisation (refer paragraph 22 of this Prudential Standard).

**[ASF Note: Please see our comments on "implicit support" in relation to paragraph 22 of APS 120 as well as our comments in relation to paragraph 1 of Attachment A.]**

## Attachment F

### Acquisition of exposures out of a pool and acquisition of securities by originating ADIs

1. The acquisition of exposures in a pool and/or securities issued by an SPV by an originating ADI may undermine the intent of a securitisation which is the transfer of credit risk. There may, however, be specific operational circumstances where the acquisition, by an originating ADI, of certain securitisation exposures is allowed.

#### *Acquisition of exposures out of a pool held by an SPV by an originating ADI*

2. An originating ADI may repurchase exposures out of a pool by exercising a clean-up call <sup>34</sup>, subject to the requirements in paragraph 3 to 6 being met. An originating ADI that intends to purchase exposures out of a pool held by an SPV in any other circumstance must contact APRA in advance for written approval.

**[ASF Note: The ASF notes the prohibition on an ADI repurchasing exposures out of a pool does not apply if it is part of a “clean up call” on satisfying the requirements of paragraphs 3 to 6. However, paragraph 2 provides that “an originating ADI that intends to purchase exposures out of a pool held by an SPV in any other circumstance must contact APRA in advance for written approval”. The ASF notes that it is common in the United States for liquidity facilities to be structured as “liquidity asset purchase agreements”. By structuring liquidity facilities in this way, ADIs can take a first ranking position effectively over the proceeds of the assets against which it has funded rather than ranking pari passu with the assets if the rated securities stay with the SPV. The ASF’s view is that, given the extent of Australian securitisation arrangements involving United States counterparties, it would be a structural improvement for APRA to permit liquidity facilities to be structured as “liquidity asset purchase agreements”.]**

3. For the purposes of sub-paragraph 2 (f) of Attachment B, if an originating ADI has the ability to make a clean-up call in relation to the pool in a traditional securitisation, the ADI may only exclude the exposures in the pool from its risk weighted asset amount if:
  - (a) the exercise of a clean-up call is at the full discretion of the ADI;

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34 A clean-up call is an option that permits the originating ADI to call the exposures in a pool before all these exposures have been fully repaid for the purpose of ending the securitisation. This is often accomplished by repurchasing the remaining exposures of a pool once the balance of the pool has fallen below a specified level. In the case of a synthetic securitisation, a clean-up call may take the form of a clause that extinguishes the credit protection.

- (b) the clean-up call is not structured to avoid allocating losses to credit enhancements or positions held by investors; and
- (c) the clean-up call cannot be exercised before 90 per cent or more of the original <sup>35</sup> pool has been amortised, unless approved in writing by APRA.

**[ASF Note: The ASF notes that the Discussion Paper accompanying draft APS 120 suggests that the 10% limit is to be removed, but it would appear from this provision that it still applies. The ASF submits that this should be clarified, the ASF's preference being that the limit be removed.]**

**In addition, the ASF submits that provisions should be included in draft APS 120 allowing for date-based call options. So that such calls are permissible in circumstances where exercise by the SPV of the call does not result in purchase of the exposures by the originating ADI.]**

- 4. For the purposes of sub-paragraph 3 (e) of Attachment B, an ~~originating~~ ADI cannot recognise, for regulatory capital purposes, the use of credit risk mitigation techniques in a synthetic securitisation if the securitisation includes a clean-up call that does not meet the criteria detailed in paragraph 3.

**[ASF Note: Please also see our comments in relation to the definition of "originating ADI" in paragraph 5(i) of APS120. Please also see our comments in relation to paragraph 3 above.]**

- 5. Where an SPV has the ability to offer to redeem the securitisation before its contractual maturity and the conditions of the agreement underlying the securitisation include incentives that would make it attractive for the originating ADI if that option were exercised (e.g. a step-up margin), the originating ADI must demonstrate to APRA that the securitisation will not be redeemed before 90 per cent or more of the original balance of the pool balance has been amortised.
- 6. An ADI acting as a servicing ADI may repurchase or replace exposures out of a pool held by an SPV if:
  - (a) the purchase or replacement is conducted at arm's length, on market terms and conditions and is subject to the ADI's normal credit approval and review processes;
  - (b) the ADI has no pre-existing obligation to undertake the purchase or replacement;
  - (c) the purchase or replacement is completed within six months from the time when the ADI commits to the purchase or replacement;

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35 As determined at the inception of the securitisation. For multi-seller vehicles, the ADI must determine 90% of its part in the original pool.

- (d) the purchased or replaced exposures are not in default; and
- (e) the exposures ~~out of the pool held by the SPV~~ are purchased or replaced to grant a further advance to the borrower or for such other purpose approved in writing by APRA.

[ASF Note: These amendments are designed to replicate the opening words of paragraph 6 throughout paragraph 6. The additional words which have been added are designed to leave open that there are other reasons why exposures may be repurchased or replaced by a servicing ADI, such as where a borrower wishes to use a feature under the loan which will mean that the loan no longer satisfies the relevant eligibility criteria with respect to that loan remaining in the pool.]

In addition, paragraph (d) should make it clear that an ADI acting as servicer may repurchase or replace exposures from a pool held by an SPV if the purchased exposures are in default and the ADI materially breached a representation in respect of that purchased exposure (in the context of whether or not the asset defaulted) within a 120 day period after the occurrence of the breach and otherwise in accordance with paragraph 15 of Attachment F.]

- 7. Where exposures from a pool are repurchased by an originating ADI, and the conditions in paragraph 6 are not satisfied, ~~then APRA may assess that the originating ADI's will be taken to be providing implicit support for the purposes of paragraph 22 of this Prudential Standard~~ purchase implies that it is supporting those exposures and the acquisition may be considered, by APRA, as implicit support within the meaning of paragraph 22 of this Prudential Standard.

[ASF Note: These amendments are to make clear that paragraph 7 is concerned with originating ADIs and that the consequences of not satisfying the requirements may constitute implicit support. The amended language regarding implicit support is consistent with the similar concept in paragraph 12 of this Attachment F. Please also see our comments in relation to the definition of "originating ADI" in paragraph 5(i) of APS120 and our comments in relation to "implicit support" on paragraph 22 of APS 120 and paragraph 1 of Attachment A.]

*Acquisition by an originating ADI of securities issued by an SPV*

- 8. An originating ADI must not purchase securities issued by the SPV unless:
  - (a) the purchase is conducted at arm's length, on market terms and conditions (including price/fee) and is subject to the ADI's normal credit approval and review processes;
  - (b) the ADI has no pre-existing obligation to undertake the purchase;

- (c) the purchase is completed within six months from the time when the ADI commits to the purchase;
- (d) the volume of purchases is not disproportionate to the amount of securities issued by the SPV (i.e. less than 20 per cent of the value of securities outstanding). For the application of the 20 per cent limit, the ADI must aggregate securities held in its trading and banking books. An ADI must obtain APRA's written approval for holdings over 20 per cent at the start of the securitisation; and
- (e) the ADI has adequate systems and controls in place to ensure that it does not accumulate disproportionate levels of aggregate exposure to securities issued by SPVs, relative to the ADI's total assets and regulatory capital.

[ASF Note: The ASF notes that this requirement has been amended from the original prudential standard so that it applies only to "originating ADIs". The ASF queries whether it is intended to apply to the wider definition of "originating ADI" or merely the ADI that originated the assets? The ASF submits that a third party ADI who is acting on an arms length basis should not be restricted in purchasing securities merely because it may have acted as a dealer, swap provider or any other facility provider for the issue, when an ADI that has no involvement is not so restricted. The ASF therefore submits that this paragraph should be limited in application to ADIs that originated the relevant assets.]

- 9. Paragraph 8 does not apply when the ADI has acquired the securities as a consequence of underwriting the securitisation at inception. Such a transaction is subject to the conditions detailed in Attachment E. Paragraph 8 (d) does not apply when an ADI undertakes a market in securities that complies with paragraph 10.
- 10. An originating ADI must not undertake a market in securities (**dealing**) issued by an SPV unless:
  - (a) the ADI's role in making the market is on a reasonable endeavours basis only and the ADI is under no obligation to purchase securities at any time;

[ASF Note: The ASF's view is that an ADI should be permitted to be obligated to purchase securities after pricing has occurred and paragraph 10(a) should be amended accordingly. The ASF's view is that paragraph 10(c) is not reasonable, as the existing base of investors may be insufficient for specific transactions.]

- (b) the ADI can withdraw from its market-making role at any time following reasonable notice of no more than 90 days;
- (c) offers of prices by the ADI are broadly based and not directed solely at current investors; and

- (d) investors are informed as to the terms under which the ADI's market making activities will be conducted.
11. The purchased securities may be included in the ADI's trading book only where the requirements in AGN 116.1 are met.
  12. When securities issued by an SPV are purchased by an originating ADI and the conditions in paragraph 8 are not satisfied (other than where paragraph 8 does not apply due to the application of paragraphs 9 or 10), APRA ~~will~~may assess that the ADI's purchase implies that it is supporting investments and the acquisition ~~will~~may be considered, by APRA, as implicit support within the meaning of paragraph ~~21-22~~22 of this Prudential Standard.

**[ASF Note: The first amendment is to make clear that paragraph 12 will be subject to the operation of paragraphs 9 and 10. The second amendment corrects a cross-referencing error. Please also see our comments in relation to "implicit support" on paragraph 22 of APS 120 and paragraph 1 of Attachment A.]**

#### *Representations and warranties*

13. An ADI that provides facilities and services, or supplies exposures to a pool held by an SPV, may make representations and warranties concerning those roles or exposures. The ADI will not be required to hold capital against such representations and warranties where:
  - (a) any representation or warranty is provided only by way of a formal written agreement and the ADI is able to demonstrate that it accords with market practice (unless otherwise approved in writing by APRA);
  - (b) the ADI undertakes appropriate due diligence before providing or accepting any representation or warranty;
  - (c) the representation or warranty refers to an existing state of facts that is capable of being verified by the ADI and is within control of the ADI at the time the services are contracted or the exposures are transferred; and
  - (d) the representation or warranty is not open-ended and, in particular, does not relate to the future creditworthiness of the exposures, the performance of the SPV and/or the securities the SPV issues.
14. Where an ADI is, as a result of an incorrect representation or guarantee, required to purchase or replace exposures (or any parts of them) transferred to an SPV or third party, this must be:
  - (a) completed in all respects within 120 days of the transfer of exposures to the SPV; and
  - (b) conducted on the same terms and conditions as the original sale.

15. After the expiry of the 120 day period, an ADI must notify APRA of any instance where it has agreed to pay damages arising out of representations and warranties or where it has agreed to reassume the credit risk of exposures of a pool.
16. For the purposes of sub-paragraphs 2 (f) and 3 (e) of Attachment B, a representation or warranty of an originating ADI must comply with the requirements detailed in paragraphs 13 to 15 above.

## Attachment G

### Revolving structures and early amortisation clauses

#### *General*

1. For the purposes of sub-paragraphs 2 (i) and 3 (f) of Attachment B, an originating ADI may obtain capital relief where it transfers exposures arising from revolving facilities to a third party and retains an interest in those exposures where:
  - (a) the ADI retains the right to cancel without notice any undrawn exposures on revolving facilities whose drawn exposures have been transferred;
  - (b) the ADI is able to demonstrate to APRA that the payment of principal on the drawn exposures in the pool will be sufficient to ensure repayment of the ADI and investors over the amortisation period;
  - (c) if there is provision for early amortisation of exposures in the pool, it cannot be triggered by regulatory action affecting the transferor of the pool; and
  - (d) the ADI is not under an obligation to:
    - (i) alter the amortisation period except upon the occurrence of any specified early amortisation events; or
    - (ii) alter the principal allocation percentage that stipulates the share that investors bear in losses incurred in the pool.
2. In addition to the regulatory capital charges detailed in Attachments C and D, an ADI that transfers a pool of revolving exposures into a securitisation that contains an early amortisation provision must calculate a regulatory capital charge for all, or a portion of, the **investor interest** in accordance with the method and conditions set out in this Attachment.
3. An ADI that has transferred a pool is not required to calculate a risk-weighted asset amount against the investor interest for a securitisation with an early amortisation clause where the:
  - (a) early amortisation ends the ability of the ADI to add new exposures to the pool;
  - (b) investors remain fully exposed to all future draws by borrowers even after an early amortisation event has occurred, i.e. the risk on the underlying facilities does not return to the originating

ADI; or

- (c) early amortisation clause is triggered solely by events not related to the performance of a pool.

**[ASF Note: The ASF considers that provided the allocations remain static after amortisation has commenced, then it should be permissible for early amortisation to be triggered by pool performance. The ASF requests that APRA reconsider this requirement.]**

**[ASF Note: Paragraph 3 and 5(a) both use the term “investor interest”. The ASF assumes this is the percentage of assets in the SPV that bears the same proportion to the % of notes sold to investors? We request clarification.]**

4. For securitisations where a pool comprises revolving and non-revolving exposures, an originating ADI must apply the early amortisation treatment to that portion of the underlying pool containing revolving exposures.

**[ASF Note: The ASF submits that the term “originating ADI” should not be used here as it is only appropriate to the ADI that originated the assets as opposed to the wider definition of “originating ADI” that includes facility and service providers, managers and servicers. Further, the ASF requests clarification of what is intended by the use of the term “early amortisation treatment”.]**

*Calculation of risk-weighted asset amounts and regulatory capital*

5. An ADI that has transferred a pool must calculate the risk-weighted asset amount for the investor interest as the product of:

- (a) the investor interest;

**[ASF Note: Please see our comments in relation to paragraph 3 above.]**

- (b) the relevant CCF; and

- (c) the risk-weight relevant to the exposure type in the pool had the pool not been securitised.<sup>36</sup>

6. The CCF depends upon whether the early amortisation repays investors through a controlled or non-controlled mechanism (refer paragraphs 7 to 8). The CCF will also differ depending on whether the securitised exposures are uncommitted retail credit lines (e.g. credit card receivables) or other credit lines (e.g. revolving corporate facilities). A credit line is uncommitted if it is unconditionally cancellable by the ADI without prior notice.

<sup>36</sup> This must be calculated in accordance with APS 112 for the standardised approach. For the IRB approach, KIRB must be used.

7. For a provision to be considered a **controlled early amortisation provision**:

- (a) the originating ADI must have in place an appropriate capital/liquidity plan to ensure that it has sufficient capital and liquidity available in the event of an early amortisation;
- (b) throughout the duration of the securitisation, including the amortisation period, there must be a pro-rata sharing of interest, principal, expenses, losses and recoveries based on the ADI's and investors' relative shares of the receivables outstanding at the beginning of each month;

[ASF Note: A similar issue to that raised in relation to paragraph 3(c) above applies to this paragraph and the ASF requests that APRA reconsider this requirement.]

- (c) the originating ADI must have set a period for amortisation that is expected sufficient for at least 90 per cent of the total amount outstanding at the beginning of the amortisation period to be repaid or recognised as in default; and
- (d) the pace of repayment must not be any more rapid than what would occur under a straight-line amortisation over the period outlined in sub-paragraph 7 (c).

[ASF Note: The ASF submits that the use of the broader defined term "originating ADI" in the context of the obligations in that this paragraph is inappropriate. For example, the ASF submits that APRA could not have intended that every dealer, underwriter, service provider or facility provider would have a liquidity plan in place.]

8. An early amortisation provision that does not satisfy the conditions detailed in paragraph 7 for a controlled early amortisation provision must be treated as a **non-controlled early amortisation provision**.

*Determination of credit conversion factors for controlled and non-controlled early amortisation features*

- 9. To determine the relevant CCF for an uncommitted retail credit line in a securitisation containing controlled or non-controlled early amortisation features (refer paragraphs 7 to 8), the originating ADI must first divide the three-month average excess spread by the level at which the SPV (as outlined in the legal documentation of the securitisation) is required to trap excess spread in a spread or reserve account (i.e. **excess spread trapping point**), and express it as a percentage.
- 10. For the purposes of this Prudential Standard, where the securitisation does not require excess spread to be trapped, the trapping point is deemed to be 4.5 percentage points higher than the excess spread level at which the early amortisation is triggered.

11. For controlled early amortisation structures, the following CCFs apply:

<b>Uncommitted</b>	<b>CCF %</b>
<b>Retail credit lines 3 month average excess spread</b>	
133.33% or more of trapping point	0
less than 133.33% to 100% of trapping point	1
less than 100% to 75% of trapping point	2
less than 75% to 50% of trapping point	10
less than 50% to 25% of trapping point	20
less than 25%	40
<b>Non-retail credit lines</b>	90
<b>Committed</b>	
<b>Retail credit lines</b>	90
<b>Non-retail credit lines</b>	90

12. For non-controlled early amortisation structures, the following CCFs apply:

<b>Uncommitted</b>	<b>CCF %</b>
<b>Retail credit lines 3 month average excess spread</b>	
133.33% or more of trapping point	0
less than 133.33% to 100% of trapping point	5
less than 100% to 75% of trapping point	15
less than 75% to 50% of trapping point	50
less than 50% of trapping point	100
<b>Non-retail credit lines</b>	100
<b>Committed</b>	
<b>Retail credit lines</b>	100
<b>Non-retail credit lines</b>	100

### *Maximum capital requirement*

13. For an ADI subject to the additional early amortisation regulatory capital requirement detailed in this Attachment, the total regulatory capital requirement for credit risk on all of its positions will be subject to a maximum capital requirement equal to the greater of:
- that required for retained securitisation exposures; or
  - the regulatory capital requirement that would apply had the exposures not been securitised.