

***Banking (prudential standard) determination No. 6 of 2023***

**EXPLANATORY STATEMENT**

**Prepared by the Australian Prudential Regulation Authority (APRA)**

*Banking Act 1959*, section 11AF

APRA may, in writing, determine, vary or revoke a prudential standard that applies to authorised deposit-taking institutions (ADIs) and authorised non-operating holding companies (authorised NOHCs) under subsection 11AF(1) and (3) of the *Banking Act 1959* (the Act).

On 21 November 2023, APRA made *Banking (prudential standard) determination No. 6 of 2023* (the instrument), which revokes *Prudential Standard APS 120 Securitisation* made under *Banking (prudential standard) determination No. 2 of 2023* and determines a new *Prudential Standard APS 120 Securitisation* (APS 120).

The instrument commences on 1 January 2024.

**1. Background**

APRA's mandate is to ensure the safety and soundness of prudentially regulated financial institutions so that they can meet their financial promises to depositors, policyholders and fund members within a stable, efficient and competitive financial system.

APRA carries out this mandate through a multi-layered prudential framework that encompasses licensing and supervision of institutions. In the case of the banking industry, APRA is empowered under the Act to issue legally binding prudential standards that set out specific prudential requirements with which ADIs must comply.

One of the key components of APRA's prudential framework is the suite of prudential standards which require ADIs to hold regulatory capital as a buffer against the risks which they undertake (capital standards). These capital standards include APS 120.

Securitisation involves selling a 'pool' of assets (typically loans) to a special purpose vehicle (SPV), which then obtains funding for these assets from the capital markets. Where significant credit risk associated with the 'pool' is transferred to third parties, ADIs may receive relief from regulatory capital requirements.

APS 120 sets out the criteria that an ADI must meet to achieve regulatory capital relief, as well as general requirements applying to an ADI's involvement in all types of securitisation activities and the methodology for calculating an ADI's capital requirement for securitisation exposures (risk positions held by an ADI arising from securitisation such as securities issued by an SPV to fund the 'pool' of assets).

**2. Purpose and operation of the instrument**

The purpose of the instrument is to revoke APS 120 made under *Banking (prudential standard) determination No. 2 of 2023* and replace it with a new version of the prudential standard incorporating minor updates.

As part of a process to ensure minor updates to APRA's prudential framework are made in a timely manner, and part of APRA's strategic initiative to modernise the prudential architecture, APRA is making minor amendments to APS 120.<sup>1</sup> The minor amendments to APS 120 involve minor corrections to references and do not present any material change in policy settings.

The key provisions in APS 120 are:

- a requirement for an ADI to have a risk management framework covering its involvement in a securitisation (including due diligence requirements and a self-assessment process) and ensure there is clear and prominent disclosure of the nature and limitations of its obligations arising from its involvement in a securitisation;
- a simple and objective test for determining regulatory capital relief for the securitised loans, which provides greater transparency for ADIs;
- the explicit recognition of securitisation for funding-only purposes (no regulatory capital relief for securitised loans) to promote long-term, stable wholesale funding of assets and to facilitate liquidity arrangements through self-securitisation with the Reserve Bank of Australia;
- ineligibility of complex and opaque securitisation such as securitisation of revolving credit facilities (e.g. credit cards), asset-backed commercial paper securitisation (e.g. programs that issue short-term commercial paper to fund long-term assets) and synthetic securitisation (e.g. securitisation that involves credit derivatives) to obtain regulatory capital relief;
- simple and transparent approaches to calculating regulatory capital for securitisation exposures. In particular, the prudential standard requires all ADIs to use:
  - a risk weight schedule to determine regulatory capital for externally-rated securitisation exposures; and
  - a supervisory formula approach to determine regulatory capital for unrated securitisation exposures.
- Both approaches are subject to minimum capital requirements (a risk weight floor) to guard against inappropriate regulatory arbitrage and there are some maximum capital requirements (e.g. a risk weight cap for senior securitisation exposures to ensure exposures are not excessively capitalised and an overall cap to ensure that the sum of the capital charges applied to retained securitisation exposures is not excessive).

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<sup>1</sup> [Prudential Framework minor updates](#), APRA (Letter, June 2023) and [Modernising the prudential architecture](#), APRA (Information Paper, September 2022).

- If an ADI cannot use these approaches, a Common Equity Tier 1 (CET1) capital deduction applies to the securitisation exposure. Notwithstanding the approaches, a resecuritisation exposure (e.g. a securitisation of a securitisation) must be deducted from CET1 capital.

There are also some prior notification requirements for certain other secured funding arrangements. Such arrangements could be highly structured securities and haircuts on the value of the securities could be much higher (with consequent larger amounts of over-collateralisation of assets involved), which may be detrimental to the protection of depositors' interests.

APS 120 provides for some transition arrangements for securitisation transactions entered into prior to 1 January 2018. This is necessary to accommodate some legacy arrangements such as legally-binding commercial agreements entered into by ADIs in their securitisations before the commencement of previous versions of APS 120.

### ***Exercise of discretion by APRA***

APS 120 provides for APRA to exercise various discretions. Decisions made by APRA exercising those discretions are not subject to merits review. This is because these decisions are preliminary decisions that may facilitate or lead to substantive decisions which are subject to merits review.

A breach of a prudential standard is also a breach of the Act, as the Act provides that regulated entities must comply with the standard. However, there are no penalties prescribed for such breaches. Instead, an ADI's breach of a provision in the Act is grounds for APRA to make further, substantive decisions under the Act in relation to the ADI. Those decisions are:

- (a) to revoke an authority to carry on banking business (section 9A of the Act); and
- (b) to issue a direction to the ADI, including a direction to comply with the whole or part of a prudential standard (section 11CA of the Act).

It is only at this stage that an ADI is exposed to a penalty: loss of its authority under section 9A or 50 penalty units if it breaches the direction (section 11CG of the Act). In nearly all cases<sup>2</sup> the decision is preceded by a full consultation with the ADI to raise any concerns it may have in relation to the decision.

A decision of APRA to impose a direction is subject to merits review under section 11CA of the Act, which is appropriately available at the point where an ADI could be exposed to a penalty.

A decision of APRA to revoke an authority under the Act is subject to merits review, unless either:

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<sup>2</sup> Subsection 9A(4) of the Act specifically provides that APRA does not need to consult where APRA is satisfied that doing so could result in a delay in revocation that would be:

- (a) contrary to the national interest; or
- (b) contrary to the interests of depositors with the ADI.

- (a) APRA has determined that access to natural justice and merits review is contrary to the national interest or contrary to the interests of depositors with the ADI; or
- (b) the authority is an authority that is to cease to have effect on a day specified in the authority (section 9A(8) of the Act).

### ***Adjust and exclude powers***

APS 120 gives APRA the discretion to adjust or exclude a provision of the prudential standard (paragraph 83). The power to create such a discretion is provided for under subsection 11AF(2) of the Act.

APRA may exercise this power when it is satisfied that the adjustment or exclusion of a specific requirement for one or more specified regulated entities will better support APRA in meeting its objectives. For example, the adjustment or exclusion may be necessary to obtain a better prudential outcome than would be the case if the prudential requirement were applied unaltered to a particular regulated entity. A tailored approach would give APRA comfort that the prudential requirements apply appropriately to protect the interests of depositors, policyholders and fund members. APRA will also take into account other considerations, such as efficiency, competition, contestability, competitive neutrality and regulatory burden, including comparisons with an entity's peer group.

The exercise of APRA's powers is governed by a robust decision-making framework which is documented in APRA's internal policies. This framework supports APRA in fulfilling its mandate by limiting decision making to those senior APRA officers with the appropriate experience and skill to exercise prudent judgement. The framework also requires decision makers to seek advice from internal technical experts.

### ***Documents incorporated by reference***

Under paragraph 14(1)(a) of the *Legislation Act 2003*, APS 120 incorporates by reference the following documents as in force from time to time:

- Acts of Parliament and associated delegated laws;
- Australian Accounting Standards; and
- Prudential Standards determined by APRA under subsection 11AF(1) of the Act.

All documents incorporated by reference in this standard are available on the Federal Register of Legislation at [www.legislation.gov.au](http://www.legislation.gov.au).

### **3. Consultation**

APRA consulted on the minor updates to APS 120 in June 2023. Five submissions were received on the proposed minor updates and submissions did not object to these.

### **4. Regulation Impact Statement**

The Office of Impact Analysis advised that no Regulation Impact Statement was required as the changes to the standards are minor and machinery.

**5. Statement of compatibility prepared in accordance with Part 3 of the *Human Rights (Parliamentary Scrutiny) Act 2011***

A Statement of compatibility prepared in accordance with Part 3 of the *Human Rights (Parliamentary Scrutiny) Act 2011* is provided at Attachment A to this Explanatory Statement.

## ATTACHMENT A

### **Statement of Compatibility with Human Rights**

Prepared in accordance with Part 3 of the *Human Rights (Parliamentary Scrutiny) Act 2011*.

#### ***Banking (prudential standard) determination No. 6 of 2023***

This legislative instrument is compatible with the human rights and freedoms recognised or declared in the international instruments listed in section 3 of the *Human Rights (Parliamentary Scrutiny) Act 2011* (HRPS Act).

#### **Overview of the Legislative Instrument**

The purpose of the legislative instrument is to revoke *Prudential Standard APS 120 Securitisation* (APS 120) and replace it with a new version of the prudential standard.

APS 120 sets out prudential requirements that apply to authorised deposit-taking institutions (ADIs). ADIs are bodies corporate that have been granted the authority, under the *Banking Act 1959*, to carry on banking business in Australia.

#### **Human rights implications**

APRA has assessed the legislative instrument and is of the view that it does not engage any of the applicable rights or freedoms recognised or declared in the international instruments listed in section 3 of the HRPS Act. Accordingly, in APRA's assessment, the legislative instrument is compatible with human rights.

#### **Conclusion**

This legislative instrument is compatible with human rights as it does not raise any human rights issues.