



Prudential Standard APS 150

Capital Adequacy: Basel II Transition (Advanced ADIs)

Objective and key requirements of this Prudential Standard

By applying transitional capital floors, this Prudential Standard aims to ensure there are no unanticipated large reductions in minimum capital requirements for authorised deposit-taking institutions approved to use the advanced approaches when the Basel II Framework comes into effect in Australia on 1 January 2008. The transitional floors will provide time for APRA to ensure that individual ADI applications of the advanced approaches are sound.

The key requirements of this Prudential Standard are that:

- an authorised deposit-taking institution approved by APRA to use an internal ratings-based approach to credit risk and an advanced measurement approach to operational risk must hold regulatory capital calculated by reference to a transitional floor adjusted risk-weighted assets figure determined with reference to the capital that would have been required had capital adequacy standards applying prior to 1 January 2008 remained in force; and
- an authorised deposit-taking institution that before 1 January 2008 has applied for approval to use an internal ratings-based approach to credit risk and/or an advanced measurement approach to operational risk may seek approval from APRA to continue holding capital, in the period prior to approval, in accordance with capital adequacy standards applying prior to 1 January 2008.

An authorised deposit-taking institution to which this Prudential Standard applies must report under Transitional Reporting Standard ARS 150 made under section 13 of the *Financial Sector (Collection of Data) Act 2001*.

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Authority

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

Application

2. This Prudential Standard applies to ADIs that have sought or been given approval to use an internal ratings-based (**IRB**) approach to credit risk and/or an advanced measurement approach (**AMA**) to operational risk.
3. A reference to an ADI in this Prudential Standard shall be taken as a reference to:
 - (a) an ADI on a **Level 1** basis; and
 - (b) a group of which an ADI is a member on a **Level 2** basis.

Level 1 and Level 2 have the meaning in *Prudential Standard APS 110 Capital Adequacy (APS 110)*.

Where an ADI to which this Prudential Standard applies is a subsidiary of an authorised non-operating holding company (**authorised NOHC**), the authorised NOHC must ensure that the requirements in this Prudential Standard are met on a Level 2 basis, where applicable.

Definitions

4. For the purposes of this Prudential Standard:
 - (a) **AIFRS** - Australian equivalents of International Financial Reporting Standards;
 - (b) **AMA approval** - approval to use an AMA under *Prudential Standard APS 115: Capital Adequacy: Advanced Measurement Approach to Operational Risk*;
 - (c) **Basel I capital adequacy standards** - the Prudential Standards relating to capital adequacy as in force immediately before 1 January 2008;
 - (d) **Basel II capital adequacy standards** - the Prudential Standards relating to capital adequacy as in force on or after 1 January 2008;
 - (e) **IRB approval** - approval to use an IRB approach under *Prudential Standard APS 113 Capital Adequacy: Internal Ratings-based Approach to Credit Risk*;
 - (f) **new APS 110** - *Prudential Standard APS 110 Capital Adequacy*, as in force on or after 1 January 2008;

- (g) **new APS 111** - *Prudential Standard APS 111 Capital Adequacy: Measurement of Capital*, as in force on or after 1 January 2008;
- (h) **old APS 110** - *Prudential Standard APS 110 Capital Adequacy*, as in force immediately before 1 January 2008; and
- (i) **old APS 111** - *Prudential Standard APS 111 Capital Adequacy: Measurement of Capital*, as in force immediately before 1 January 2008.

Key principles

5. For a transitional period commencing with implementation of the Basel II Framework (set out in *International Convergence of Capital Measurement and Capital Standards: A Revised Framework*) in Australia, APRA will limit reductions in minimum regulatory capital allowable to an ADI that has IRB and AMA approval, relative to what would have been required had Basel I remained in force. This limit will be implemented by way of a transitional floor on the risk-weighted assets (**RWA**) figure used for determining the ADI's actual risk-based capital ratio and whether it meets its prudential capital ratio (**PCR**). The method of calculating the transitional floor adjusted RWA figure is detailed in paragraphs 7 to 12 of this Prudential Standard. Separate transitional floors will be calculated at Level 1 and Level 2 as defined in paragraph 3 above.
6. An ADI that as at 1 January 2008 has IRB and/or AMA approval pending may seek APRA's consent to the ADI holding capital in accordance with the Basel I capital adequacy standards until the ADI has received both approvals.

Calculation of the transitional floor

7. Descriptions of the terms used to calculate the Basel II transitional floor adjusted RWA as detailed in paragraph 8 of this Prudential Standard are provided below.

RWA(F)	the Basel II transitional floor adjusted RWA.
A	transitional floor RWA adjustment.
GC(B1)	gross capital under the Basel I capital adequacy standards.
GC(B2)	gross capital under the Basel II capital adequacy standards.
RWA(B1)	total risk-weighted exposures under the Basel I capital adequacy standards.
RWA(B2)	unadjusted total RWA under the Basel II capital adequacy standards.
TFP	the transitional floor percentage set under paragraph 10 or, if applicable, paragraph 11 of this Prudential Standard.

- PCR** the prudential capital ratio, being the minimum total risk-based capital ratio set by APRA under APS 110.
- P(B1)** General Reserve for Credit Losses included in eligible capital under the Basel I capital adequacy standards. For the avoidance of doubt, the eligible General Reserve for Credit Losses is unadjusted for any income tax effects.
- D(B1)** total capital deductions required under the Basel I capital adequacy standards. For the avoidance of doubt, the AIFRS - related transitional additions to the eligible capital base referred to in paragraph 1 of the Attachment to old APS 111 are not considered to be a reduction in Basel I total capital deductions for the purpose of calculating the Basel II transitional capital floor under this standard.
- P(B2)** excess of provisions over expected losses eligible for inclusion in capital under the Basel II capital adequacy standards. For the avoidance of doubt, the provision and expected credit loss numbers are unadjusted for any income tax effects.
- D(B2)** total capital deductions required under the Basel II capital adequacy standards.

8. An ADI that has IRB and AMA approval must, for the purposes of determining its actual risk-based capital ratio and whether it meets its PCR, calculate a Basel II transitional floor adjusted RWA denominator using the following formula:

$$\mathbf{RWA(F)} = \max\{\mathbf{RWA(B2)}, [\mathbf{RWA(B2)} + \mathbf{A}]\}$$

where

$$\mathbf{A} = [(\mathbf{GC(B1)} \times \mathbf{TFP}) - \mathbf{GC(B2)}] / \mathbf{PCR}$$

$$\mathbf{GC(B1)} = [\mathbf{RWA(B1)} \times \mathbf{PCR}] + \mathbf{D(B1)} - \mathbf{P(B1)}$$

$$\mathbf{GC(B2)} = [\mathbf{RWA(B2)} \times \mathbf{PCR}] + \mathbf{D(B2)} - \mathbf{P(B2)}$$

9. An ADI must, at a minimum, calculate the Basel II transitional floor adjusted RWA on a quarterly basis and substitute it for the “total RWA” denominator in paragraph 3 of new APS 110.
10. The transitional floor percentage is set at 90 per cent, subject to paragraphs 11 and 12.
11. APRA may, in writing, vary the transitional floor percentage for, or terminate application of the transitional treatment to, either a particular ADI or all IRB and AMA approved ADIs as a group.
12. APRA’s exercise of its discretion under paragraph 11 will depend on APRA being satisfied that the varied or unadjusted Basel II risk-based capital calculations will provide for a sufficiently comprehensive and prudent level of

capital, having regard to the risks to which the ADI or ADIs concerned are exposed.

ADIs in relation to which IRB and/or AMA approval is pending

13. Paragraph 14 applies to an ADI that:
 - (a) before 1 January 2008 applied to APRA for an IRB or an AMA approval, or both; and
 - (b) as at 1 January 2008 has not yet received both an IRB and an AMA approval.
14. An ADI to which this paragraph applies may seek APRA's consent, in writing, to the ADI holding capital in accordance with the Basel I capital adequacy standards until the ADI has received both IRB and AMA approval. APRA's consent may contain conditions, including an expiry date.
15. For the avoidance of doubt, when an ADI has been given both an IRB and an AMA approval, paragraphs 7 to 12 will begin to apply to the ADI.