

02 October 2015

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Dear Pat

Minor Clarification - Countercyclical Capital Buffer

The Australian Bankers' Association (**ABA**) welcomes the opportunity to provide feedback on the draft version of *Prudential Standard APS 110 Capital Adequacy (APS 110)*, in particular the proposed amendment to the countercyclical capital buffer (**CCyb**) requirements which commence on 1 January 2016.

With the active participation of its members, the ABA provides analysis, advice and advocacy for the banking industry and contributes to the development of public policy on banking and other financial services. The ABA works with government, regulators and other stakeholders to improve public awareness and understanding of the industry's contribution to the economy and to ensure Australia's banking customers continue to benefit from a stable, competitive and accessible banking industry.

The ABA provides the following comments in response to APRA's proposed changes to APS 110.

Recognition of CCyBs from other jurisdictions

The ABA notes that APRA has redrafted paragraph 32 of APS 110 to state that APRA will only inform ADIs of any decision to increase the CCyB *for exposures in Australia*. The current drafting creates a disconnection with Appendix C which refers to exposures both in and outside of Australia. In order to provide clarity, the ABA suggests the following amendments to paragraphs 31 and 32:

31. Any countercyclical capital buffer is to be calculated in accordance with Attachment C and APRA will advise ADIs of the countercyclical capital buffer requirements in other jurisdictions which must be included in the calculation.
32. APRA will inform ADIs of any decision to set, or increase, the level of the countercyclical capital buffer up to 12 months from the date from which it applies. Any decision to decrease the level of a countercyclical capital buffer will take effect immediately.

The ABA's amended wording is consistent with the requirements of the Basel Committee's *Basel III: A global regulatory framework for more resilient banks and banking systems*¹, in particular paragraph 141 and associated footnote #49, which states that home authorities should seek to match the preannouncement period announced by the domestic regulator announcing the CCyB increase. Further, the ABA notes in paragraph 4 of Attachment C that APRA may impose a higher CCyB than that applied by a local domestic regulator. The standard, as currently drafted, does not provide a process by which APRA will announce that determination and the effective date.

¹ <http://www.bis.org/publ/bcbs189.pdf> (June 2011)



A materiality threshold for offshore CCyB announcements applying to an Australian ADI's Level 1 or Level 2 CCyB calculation should be incorporated to avoid an excessive regulatory burden given the significant resourcing needed to calculate immaterial CCyB requirements. The ABA notes that the European Banking Authority² announced a materiality threshold for foreign credit exposures of 2% of Group RWA before the offshore CCyB had to be incorporated in European banks' calculations.

Application of CCyBs from other jurisdictions

The ABA notes that APRA will also release guidance on the calculation of the CCyB at the time of finalising the prudential standard. We request that this guidance also address the following:

- How offshore CCyB announcements that are product or industry specific are to be applied within the Australian calculation. The ABA requests that APRA clarify that industry or product specific buffers should only apply to Australian banks that have such direct exposures e.g. Switzerland's regulator applied a CCyB that related solely to the level of mortgage exposures.
- APRA should consider adopting CCyB on a transitional basis (as adopted offshore) to ensure consistency and equitable treatment of Australian ADIs with offshore banks as:
 - Australian ADIs will be required to apply fully the countercyclical capital buffer to their Australian exposures, while offshore banks (and their branches) operating in Australia would apply the transitional arrangements adopted by their home regulator.
 - Australian ADIs operating offshore may be required, by paragraph 30 of APS 110, to apply the full CCyB to offshore assets whereas local banks in those offshore jurisdictions may be able to apply transitional arrangements adopted by the local regulator for the same assets.

The ABA also requests that APRA confirm in APS 110 that for offshore Private Sector Credit exposures, it is APRA's risk-weighted asset calculation and not the local risk-weighted asset calculation that is relevant for the APRA CCyB calculation.

Private credit exposure definition

Proposed amendments to paragraphs 1 and 2 of Attachment C changes the definition of "Private Sector Credit" from "*include all private credit exposures that attract a credit risk capital charge*" to "*are exposures that attract a credit risk capital charge*" (italics added). The ABA has the following concerns with APRA's proposed amendments:

- The APRA proposals are inconsistent with definitions used by overseas regulators which creates confusion, particularly if an Australian ADI has exposures in that offshore jurisdiction.
- The APRA proposals have the effect of incorporating all exposures that attract a credit charge, not merely 'private credit exposures' – exposures such as banks, sovereigns, and public sector enterprises would be captured, whereas the Hong Kong Monetary Authority (HKMA) definition³ excludes such exposures.

² European Banking Authority Guideline:

<http://www.eba.europa.eu/documents/10180/937795/EBA+RTS+2014+17+%28Final+Draft+RTS+on+CCB+Disclosure%29.pdf/f1d6fa39-b308-4835-b8f5-f80e3bfef51e>

³ Definition of Private Sector Credit Exposure under HKMA Bank Capital Rules: http://www.hkma.gov.hk/media/eng/doc/key-functions/banking-stability/basel-3/banking_capital_rule.pdf Page 18 and 19 of document defines the exposure and also make references to Credit RWA



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- The proposed drafting refers to a “credit risk capital charge”, but doesn’t define the term. The term “charge” is usually a reference to a P&L expense for ‘loan loss provisioning’. The ABA notes that HKMA⁴ refers to “a risk-weighted amount” rather than a “charge”.

To ensure consistency of application, the ABA requests that APRA review the drafting of the definition of private sector credit to align with offshore regulators.

Furthermore, paragraph 5 of Attachment C, specifically identifies Level 2 incorporating exposures held by non-ADI subsidiaries. The ABA notes that this could also occur at Level 1 through subsidiaries being eligible for Level 1 via the Extended Licensed Entity concept. As such, the ABA would welcome APRA clarifying and providing guidance on the treatment of Level 1 exposures held by non-ADI subsidiaries.

Disclosure

The ABA notes that the enhanced Pillar 3 disclosures require banks to disclose private sector credit exposures in jurisdictions where the CCyB applies. The ABA would welcome clarification from APRA that this disclosure requirement only applies if the CCyB has been activated by APRA. Further, if a materiality threshold is introduced, the ABA recommends that the disclosure of private sector credit exposures should only be required where these exposures are greater than the materiality threshold. This will ensure clarity on what exposures form part of the CCyB requirement.

Thank you for taking our comments into consideration. The ABA and its members are happy to meet with APRA to further discuss any of the above comments.

Yours sincerely

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⁴ Definition of Private Sector Credit Exposure under HKMA Bank Capital Rules: http://www.hkma.gov.hk/media/eng/doc/key-functions/banking-stability/basel-3/banking_capital_rule.pdf Page 18 and 19 of document defines the exposure and also make references to Credit RWA