AUSTRALIAN PRUDENTIAL REGULATION AUTHORITY
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TO: ALL AUTHORISED DEPOSIT-TAKING INSTITUTIONS

RESPONSE TO SUBMISSIONS – THE LEVERAGE RATIO

The leverage ratio requirement is a key component of the global bank capital reforms and is designed to complement the risk-based capital framework by limiting the amount of debt that can be used to fund bank lending. APRA initially consulted on the introduction of a leverage ratio requirement for authorised deposit-taking institutions (ADIs) in February 2018 and subsequently consulted on a draft *Prudential Standard APS 110 Capital Adequacy* (APS 110) and a draft *Reporting Standard ARS 110.1 Leverage Ratio* (ARS 110.1) in November 2018. APRA received five submissions in response to the November 2018 consultation. Non-confidential submissions have been published on APRA's website.

This letter sets out APRA's response to the November 2018 consultation and also proposes further amendments to incorporate recent technical changes to the Basel Committee on Banking Supervision's (Basel Committee) leverage ratio standard. The proposals outlined in this letter relate solely to the leverage ratio requirement for ADIs that apply the internal ratings-based (IRB) approach to credit risk.

Additional amendments to the leverage ratio requirement

Subsequent to APRA's November 2018 consultation, the Basel Committee released a revised leverage ratio standard that amended the treatment of client cleared derivatives. The revised treatment allows banks to apply the standardised approach to measuring counterparty credit risk (SA-CCR) to its client exposures. This amendment seeks to ensure that the leverage ratio does not discourage banks from providing client clearing services.

APRA is proposing to adopt the Basel Committee's revised treatment for client cleared derivatives. The amendments that would give effect to this proposal are marked-up in the accompanying draft revised APS 110.

Early adoption of modified SA-CCR

The calculation of the leverage ratio as a minimum capital requirement requires IRB ADIs to calculate counterparty credit risk for derivative exposures using a modified version of SA-CCR. This approach is different to the current calculation of the leverage ratio for public disclosure, which requires the use of the current exposure method (CEM).

Comments received

From 1 July 2019, SA-CCR replaced CEM for the purpose of calculating counterparty credit risk capital requirements in the risk-based capital framework. A number of respondents expressed concern about being required to run two exposure measure calculations in parallel in the interim period until 1 January 2022 — SA-CCR under the risk-based capital framework and CEM under the leverage ratio public disclosure framework.

For the purpose of leverage ratio disclosures, respondents suggested that APRA either:

- allow IRB ADIs to adopt the modified SA-CCR early; or
- provide transitional relief by allowing IRB ADIs to use the risk-based version of SA-CCR until 1 January 2022, and then use modified SA-CCR from that date.

The continued use of CEM for the purpose of leverage ratio disclosures only was described as inefficient and increasing regulatory burden.

APRA’s response

APRA will allow IRB ADIs to adopt modified SA-CCR early for the purpose of their leverage ratio disclosures under *Prudential Standard APS 330 Public Disclosure*. IRB ADIs that intend to adopt modified SA-CCR early will need to seek APRA’s prior approval. For this purpose, an ADI must provide APRA with an outline of the implementation process and testing conducted to ensure that the early adoption of modified SA-CCR has been implemented correctly. The ADI must also provide a waterfall of its leverage ratio exposure measure calculation using modified SA-CCR that can be reconciled against its SA-CCR calculations under the risk-based capital framework. Where APRA is satisfied with the ADI’s implementation, it will provide the ADI with written approval to adopt modified SA-CCR early.

Those IRB ADIs that adopt early will be required to state that they are using modified SA-CCR in their public disclosures. This is a transitional issue that will be resolved from 1 January 2022, at which time all IRB ADIs will be required to use modified SA-CCR to meet both the minimum capital and public disclosure leverage ratio requirements.

Frequency of reporting requirements

APRA proposed that IRB ADIs report their leverage ratios to APRA calculated on the basis of a daily average of all exposure measure components. This proposal sought to reduce any incentives IRB ADIs might have to engage in window-dressing behaviours – that is, artificially increasing reported leverage ratios at the end of the quarter by temporarily reducing transaction volumes in financial markets (particularly derivative and securities financing transaction (SFT) markets). This behaviour has been observed in other jurisdictions which have only adopted quarter-end reporting requirements.

Comments received

Respondents were not supportive of APRA’s proposal, stating that calculating all components on a daily basis would be difficult to operationalise and introduced a disproportionate regulatory burden relative to the stated aims of the leverage ratio as a backstop measure. Respondents requested that APRA either retain the status quo (i.e. reporting as at quarter-end only) or adopt a monthly average measure, in line with financial accounting reporting requirements.

APRA’s response

Subsequent to APRA’s November 2018 consultation, the Basel Committee finalised revisions to its leverage ratio disclosure requirements to address window-dressing concerns. These revisions require that banks calculate daily average values for SFTs only; all other components of the leverage ratio are calculated as at quarter-end.

APRA is proposing to align with the Basel Committee’s revised disclosure requirements and limit the calculation of daily average values to SFT exposures. A revised leverage ratio reporting standard reflecting this requirement will be released when APRA consults more broadly on changes to reporting standards in 2020.

Next steps

The draft revised APS 110 is available on APRA's website at:

https://www.apra.gov.au/leverage-ratio-requirement-for-authorised-deposit-taking-institutions

APRA invites feedback on the draft revisions to APS 110. Written submissions on the proposal should be sent to ADIpolicy@apra.gov.au by 7 February 2020 and addressed to:

General Manager, Policy Development
Policy and Advice Division
Australian Prudential Regulation Authority

APRA intends to finalise its leverage ratio proposals by end 2020.

Yours sincerely,

John Lonsdale
Deputy Chair

Important disclosure notice – publication of submissions

All information in submissions will be made available to the public on the APRA website unless a respondent expressly requests that all or part of the submission is to remain in confidence. Automatically generated confidentiality statements in emails do not suffice for this purpose. Respondents who would like part of their submission to remain in confidence should provide this information marked as confidential in a separate attachment.

Submissions may be the subject of a request for access made under the *Freedom of Information Act 1982* (FOIA). APRA will determine such requests, if any, in accordance with the provisions of the FOIA. Information in the submission about any APRA-regulated entity that is not in the public domain and that is identified as confidential will be protected by section 56 of the *Australian Prudential Regulation Authority Act 1998* and will therefore be exempt from production under the FOIA.