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# APRA Discussion Paper: Improving the transparency, comparability and flexibility of the ADI capital framework

The Australian Banking Association (**ABA**) appreciates the opportunity to provide comments on APRA's Discussion Paper: Improving the transparency comparability and flexibility of the ADI capital framework (**discussion paper**).

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 welcomes the discussion paper which includes proposals to improve the transparency, comparability and flexibility of the capital framework. We also welcome APRA's recognition that the reported capital ratios of Australian Authorised deposit-taking institutions (ADIs) will tend to look lower than those of international peers due to APRA applying additional conservatism over and above the internationally agreed minimum requirements of Basel Committee on Banking Supervision's (Basel) capital framework. While, the ABA supports 'unquestionably strong' capital ratios, the ABA agrees with APRA[1] that this embedded conservatism makes it more difficult and/or costly for Australian ADIs to access international capital markets if these Australian differences are not well understood, particularly during times of market dislocation.

In a period of so much concurrent change to the Australian prudential framework the ABA looks forward to assisting APRA as we work towards the final design and calibration of so many interrelated parts of the Australian prudential framework.

The ABA supports APRA's proposed 'Approach 2 – Capital ratio adjustments' with modifications, the main body of this submission outlines our reasoning why. This submission also contains an appendix with ABA responses to the questions raised by APRA in the discussion paper.

## Introduction

The ABA believes that changes to improve the transparency, comparability and flexibility of the ADI capital framework should focus on further strengthening the Australian Financial System by adopting the following key principles:

- **Clear investor understanding**. A framework that allows the capital strength of Australian banks to be clearly understood by investors in both stable markets and economic conditions, and in times of market impairment or economic stress.

[1] APRA Discussion Paper: *Improving the transparency comparability and flexibility of the ADI capital framework.*

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- **Greater flexibility under stress**. The existence of usable buffers which allow Australian banks to absorb losses without breaching minimum requirements, restore capital strength to maintain market confidence and continue providing essential services to the real economy in the face of adverse shocks.
- **Complexity is minimised**. Any additional complexity introduced by the changes are managed through design decisions and clear guidelines. Any new calculations should be both mechanical and formulaic.

Of the options presented within the APRA discussion paper, the ABA strongly prefers *'Approach 2 – Capital ratios adjustments'* with some modifications which we believe provide greater resilience and flexibility under stress. To improve the transparency, comparability and flexibility of the ADI capital framework, in summary:

1. **The ABA is supportive of Approach 2- Capital ratio adjustments (with some modifications).** A framework whereby banks capital ratios are presented on a more internationally comparable basis would more accurately reflect the financial strength of Australian banks, including in times of financial stress. Given Australia's reliance on offshore markets, having an available and diverse offshore funding base is critical.
2. **Within Approach 2, the ABA supports the use of greater use of capital buffers rather than changes to minimum international requirements.** We are supportive of maintaining the minimum CET1 ratio at 4.5 per cent in line with internationally agreed Basel minimums and increasing the capital buffers to include the APRA overlay adjustment (AOA).
3. **Modifying Approach 2 to introduce a capital buffer that can be adjusted in line with systemic risk build up and is not subject to automatic distribution restrictions would maximize flexibility within the framework**. This will allow ADIs to recapitalise in an orderly manner under stress and ultimately promotes system stability.
4. **The AT1 loss absorption trigger point should be maintained at 5.125 per cent consistent with international peers**.
5. **Operational complexities can be minimised**. The ABA appreciate that Approach 2 will result in some changes in operational requirements from today. In addition to system changes, the education of internal stakeholders and external investors and analysts on the revised framework will be critical. However, the ABA strongly believes these operational complexities can be minimised and that the benefits will significantly outweigh the cost and effort required to implement these changes.

The above points are expanded upon below.

## ABA support for APRA's Approach 2 – Capital radio adjustments with modifications.

A key benefit of the adoption of Approach 2 is improved flexibility which in turn strengthens the Australian prudential framework and also adds to APRA's objective of unquestionably strong banks. As the purpose of capital is to protect depositors and creditors from unexpected losses, ensuring APRA has maximum flexibility within international standards to respond to potential stress and preserve financial system stability is a priority.  Approach 2 leads to the largest capital buffers to minimum requirements which can be applied in various ways, for example within or above the CCB or as a lever which can be adjusted in accordance with systemic risk build-up.

The ABA believes that if the differences between international Basel and APRA standards are not well understood by offshore investors, the capital strength of ADIs can be unnecessarily questioned. Despite being unquestionably strong, the ABA believes the lower headline regulatory capital ratios for Australian ADIs may become a significant issue during times of financial stress where investors are more risk sensitive, thereby increasing the difficulty or cost to raise equity/debt in international capital markets for Australian ADIs. The ABA considers it critical that there is comparability and transparency in Australian ADI capital ratios while retaining the flexibility for both APRA to ensure systemic stability.

To date, Australian ADIs have mitigated this by engaging on regular debt and capital road shows with large and sophisticated investors. However, despite extensive efforts, the recurring feedback to Australian ADIs from a number of smaller overseas investors has been that a lower headline regulatory capital ratio and lower headroom to the regulatory minimums does not meet the investment thresholds for these smaller offshore investors and as a result restricting the access to these potential pools of investors to provide the credit Australia needs. Additionally, in times of stress, it is likely that investors will refer back to the APRA ratio as the primary determinant of capital strength without regard to the internationally comparable ratio, if parallel reporting continues.

In light of the above, the ABA has a strong preference for Approach 2 with modifications, as it provides an internationally comparable and transparent template for Australian ADIs, which we consider to be broadly based on the minimum Basel capital framework. It is critical to demonstrate the absolute and relative strength of Australian ADIs in comparison to peer banks in other jurisdictions, this has particular importance in times of market stress when investors are more risk sensitive. The ABA also believes Approach 2 will maintain APRA's conservatism through the use of capital buffers, which is an essential feature to preserve capital strength and stability in the financial system, while also retaining both the flexibility and ability for APRA to intervene as necessary.

## Framework design

In order to improve the flexibility of the capital framework in a manner that allows ADIs to recapitalise in an orderly fashion during stress periods, the ABA recommends that minimum regulatory capital requirements are increased via application of a risk-sensitive AOA.

Specifically, we recommend that APRA:

1. Maintain the CET1 minimum at 4.5 per cent.
2. For each ADI, calculate the aggregate size of the AOA based on aspects of relative conservatism in APRA's capital ratio measurement approach (relative to Basel) that are material in size and able to be calculated simply and objectively (for illustration, the aggregate size of the AOA is 6 per cent in the diagram below).
3. Based on the illustrative example, the 6 per cent requirement would be introduced via the following new buffers:
    - The first component (represented as **New Buffer A** in the diagram below) would form part of the capital buffer (as defined in Attachment B of APS110) used to determine capital distribution constraints (the Maximum Distributable Amount or MDA). This component would be sized such that the dollar amount of the capital buffer would be broadly unchanged from existing levels for each ADI.
    - The second component (represented as **New Buffer B** in the diagram below) would sit above the capital buffer and could be set at an industry level. Should capital levels fall into this buffer, ADIs would be required to submit a plan to APRA for restoring the capital position within an agreed timeframe. Further comments on this approach are outlined in the section titled "introduction of a buffer that is countercyclical.

    The size of these buffers in aggregate:

    - Should be bespoke to individual ADIs reflecting different asset composition and risk intensity of each ADIs balance sheet.
    - Would be recalculated periodically in order to reflect balance sheet growth and changing balance sheet composition over time.

ABA also recommend that APRA issue clear and simple guidelines to standardise the calculation of the size of the relative APRA conservatism (which determines the size of the AOA) and to ensure that any future changes in ADIs balance sheet will 'mechanically' adjust the size of the AOA.

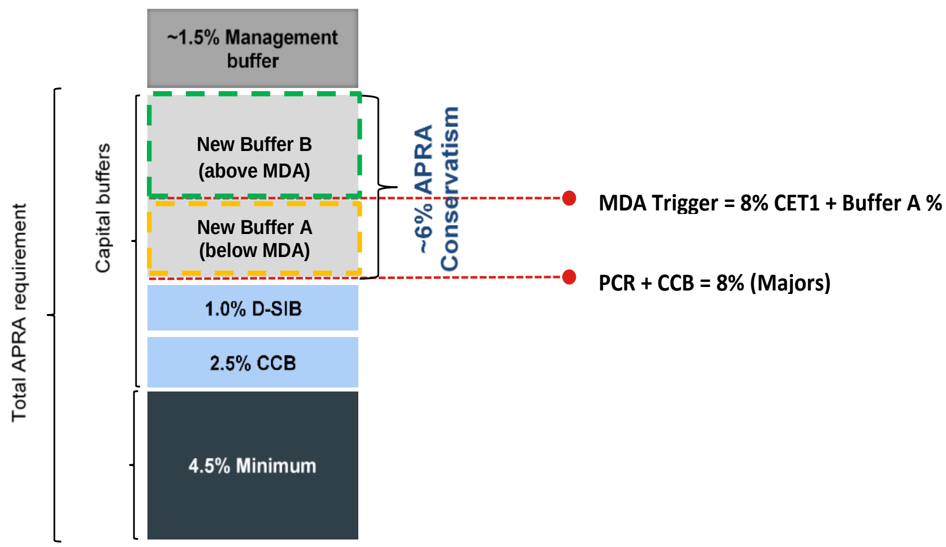
Under normal conditions, ADIs would be expected to maintain capital levels in excess of minimum capital requirements including the new buffers and a management buffer calibrated as part of the ICAAP and stress testing process.

This approach ensures that:

1. Aggregate CET1 capital levels are unchanged from current levels (based on 10.5 per cent unquestionably strong requirements); and
2. The existing dollar amount of the MDA is maintained.

The latter point is important from a stability perspective given that investors in Additional Tier 1 (**AT1**) securities closely monitor the capital buffer above the MDA amount – i.e. the point at which restrictions to distributions (including AT1 coupons) are automatically triggered.

The diagram below demonstrates this approach graphically:




## Introduction of a buffer that is countercyclical

In the example above, 'Buffer B' with the following characteristics achieve maximum flexibility within the framework when:

- Constructed as a lever, similar to a Countercyclical Capital Buffer (**CCyB**), which can be adjusted in line with systemic risk build-up. A non-zero neutral setting means that the buffer can be released in times of systemic stress, supporting ADI's in restoring capital strength and maintaining market confidence; and/or
- Positioned above the Capital Conservation Buffer (**CCB**) so as to provide APRA with full flexibility when determining a mitigating response.

A key feature of the framework design outlined in the preceding section is the ABA recommended introduction of a new countercyclical buffer that sits above MDA trigger. The use of buffers facilitates a transparent and flexible approach to achieve desired capital outcomes and ensure alignment to international frameworks whilst improving the resilience of the Australian financial system to withstand periods of stress.

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Risk weights should be based on the underlying risk of an asset and modelled using appropriately calibrated parameters. To the extent that the capital framework does not result in capital levels equivalent to a 10.5 per cent CET1 ratio under current measurement, rather than applying additional RWA overlays, APRA should consider the use of capital buffers.

Capital buffers provide more flexibility into the capital framework, given they increase the distance to automatic regulatory intervention and potentially mandatory distribution constraints without compromising on the total level of capital required. This extra distance provides supervisory flexibility when deciding on mitigating actions. In using buffers, APRA yields none of the control they have today, and gains increased capacity and time to determine appropriate actions in times of stress. The use of buffers promotes financial system stability and helps to support continued market access to address any capital deficits in a more orderly and flexible way.

Buffers can be easily adjusted and act as a lever to alter capital requirements as appropriate, creating capacity during periods of market stress. Variable buffers help to lean against the build-up of system-wide risk in periods of growth and can reduce the risk of constraining the supply of credit in downturns. This balancing mechanism also assists in stabilising the credit cycle and avoiding pro-cyclical impacts.

There is precedent in application of such a buffer in other comparable jurisdictions. The UK has a CCyB in place and set above zero in standard credit conditions. In Canada a Domestic Stability Buffer of 1.5 per cent is applied above the CCB to Domestic Systemically Important Banks (**DSIBs**), to address systemic vulnerabilities; this buffer acts similarly to the CCyB yet is more targeted in application to only DSIBs and does not result in automatic distribution constraints. A breach of the Domestic Stability Buffer requires a Canadian bank to submit a capital plan to restore capital levels above requirements within a set period of time, with power given to the regulator to intervene in a transparent and expected way if the capital plan is not executed.

The key benefit of a buffer above the CCB is to increase flexibility of the framework before ADIs are subject to mandatory restrictions. Given the Australian imputation credits regime, ADIs maintain a consistently high dividend pay-out ratio, and entering the CCB could lead to an automatic inability to pay the next AT1 distribution as a result of a recent ordinary dividend payment and the interplay with the 60 per cent cap on distributions. As AT1 instruments have dividend stoppers attached, a missed AT1 distribution leads to an inability to pay the next ordinary dividend, which will have significant repercussions on an ADI's share price and confidence in the Australian financial system. Raising capital in this situation to remediate the capital gap would be increasingly difficult, with the potential for systemic destabilising impacts flowing through the Australian financial system.

Regardless of the type of buffer, there is no change in the expectation that ADIs will remain sufficiently above all buffers in normal times and restore capital ratios above buffers post stress. Any calibration of 'buffers' will be dependent on the evolution of RWA adjustments and capital requirements as APRA finalises its revisions to the capital framework, therefore the ABA would recommend a consistent and uniform application of buffers for all IRB approach ADIs or both IRB and Standardised approach ADIs, depending on the capital gaps to final target levels.

## AT1trigger level maintained at 5.125 per cent consistent with international peers

APRA have indicated that should Approach 2 be adopted, they are considering alternative options and impacts on the Additional Tier 1 (**AT1**) capital loss absorption trigger point. We are supportive of maintaining the existing loss absorption trigger point of 5.125 per cent. The ABA supports setting a framework that achieves greater international comparability from an Australian bank Common Equity Tier 1 (**CET1**) ratio perspective, however applying a more conservative AT1 trigger level would introduce unnecessary complexity and is inconsistent with the approach to capital ratios and minimums more broadly under Approach 2.

This approach is supported by the introduction of the AOA within the capital buffers rather than minimum requirements.

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The ABA acknowledges that a small number of jurisdictions have issued instruments with a higher trigger, however most offshore jurisdictions have maintained a 5.125 per cent trigger despite higher CET1 ratios. A proposal outside of the internationally agreed framework would make marketing of Australian AT1 securities more difficult relative to international peers. Under a stressed environment, a wider buffer to the trigger would strengthen the Australian Financial System by increasing APRA's flexibility to react to a financial crisis. APRA would retain full control via the point of non-viability (**PONV**) trigger.

Activation of limitations on Additional Tier 1 payments may result in limiting the ability of ADIs' to complete ordinary share capital raisings, the very transactions required to restore the CET1 levels. Notably a number of jurisdictions (Japan, Singapore, Canada and US) do not issue AT1 instruments with CET1 triggers and their regulators solely rely on the PONV trigger.

## Practical considerations

While fully supportive of this work, the ABA wishes to highlight a number of practical considerations as APRA works to finalise the Basel III revisions and also seeks to improve the transparency, comparability and flexibility of the capital framework.

- **Final calibration of all components of the framework** – The calibration and design of Approach 2 should only be finalised once APRA finalises all revisions to the capital framework[2] [3]. The ABA believes as part of the final calibration and design a Quantitative Impact Study (**QIS**) will be a necessary precursor step. This is to ensure that the framework design for Approach 2 delivers the intended transparency, comparability and flexibility objectives, while also maintaining the quantum of capital that meets APRA's Unquestionably Strong' objectives[4].
- **Operational complexities** – To achieve both APRA's objective of a framework that is simple, calculations of buffers should be mechanical (similar to current RWA calculations). APRA should consider further simplification of the framework through more frequent adjustments to the AOA buffer.
- **Output floor** – The removal of APRA's conservatism from the Advanced Internal Ratings Based (**A-IRB**) RWA framework and applying these as buffers may have the unintended consequence of the 72.5 per cent output floor becoming a binding constraint on Australian IRB ADIs. In principle, if Australian ADIs are currently holding sufficient capital for APRA's conservatisms under the A-IRB RWA approach, that exceeds the capital required for 72.5 per cent of the Standardised Approach, then the output floor should not be a binding mechanism.
- **Implementation/Transition period** - If APRA moves to this new approach for the comparability framework it will result in changes in existing reporting processes and systems. The ABA suggest a minimum 12-month transition period from the issuance of the final standards to ensure an orderly transition.
- **Disclosure requirements** - From a disclosure perspective, the size of the AOA represents additional APRA conservatism above Basel requirements for a specific ADI. The ABA would advocate for a comprehensive disclosure of the size, measurement details and buffer composition for the entirety of the AOA within the Pillar 3 reporting requirements. This would assist with transparency and investor comparability of the risks within each individual ADI.

[2] APRA, Revisions to the capital framework for authorised deposit-taking institutions (Discussion Paper, February 2018), https://www.apra.gov.au/implementing-basel-iii-capital-reforms-australia
[3] APRA, Increasing the loss-absorbing capacity of ADIs to support orderly resolution (Discussion Paper, November 2018). https://www.apra.gov.au/sites/default/files/increasing_the_loss-absorbing_capacity_of_adis_to_support_orderly_resolution.pdf
[4] APRA, Strengthening banking sector resilience: establishing unquestionably strong capital ratios (Information Paper, July 2017), https://www.apra.gov.au/information-papers-released-apra

The ABA appreciates the efforts of APRA to improve the transparency, comparability and flexibility of the ADI capital framework. The substantial task of finalising the design of so many interrelated parts of the Australian prudential framework is a critical part of the Australian financial infrastructure. The ABA looks forward to, where possible, assisting APRA as we work towards that final calibration.

Yours sincerely

*Signed by*

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# Appendix 1 - ABA response to discussion paper questions

**Q1. What are the advantages and disadvantages of each approach (refer to Chapter 2);**

> **Approach 1 (consistent disclosure)**
> **Approach 2 (capital ratio adjustments)**
> **A combination of Approach 1 and Approach 2, applying to different aspects of material relative conservatism**
> **Status quo-retain the existing approach?**

The ABA suggests a number of refinements that it believes could further support APRA's objectives:

| **Approach (in order of preference)** | **Advantages** | **Disadvantages** |
|---|---|---|
| Approach 2: capital ratio adjustments | APRA conservatism<br>- Conservatism retained through higher capital minimum.<br>Demonstrable absolute and relative strength<br>- Closer alignment of the APRA capital framework with the Basel framework allowing investors to compare Australian ADIs with international peers.<br>Capital raising – times of stress<br>- Risk averse investors can better assess the absolute and relative strength of Australian Banks in comparison with international peers competing for the same pool of capital.<br>Capital raising – deeper investor base<br>- Ability to tap investors with higher minimum capital adequacy hurdles.<br>Simplicity<br>- Ability to simply articulate domestic conservatism through disclosure of the new discrete buffer.<br>Flexibility<br>- Increased buffers to minimum requirements and LATP.<br>- Capacity to include a variable buffer which can be reduced in times of stress to release capital.<br>- Potential to determine to which tiers of capital APRA super-equivalence should be applied.<br>- Harmonised RWA requirements enable APRA to determine to which levels of capital, super-equivalence should apply. | Complexity<br>- Dependent on final solution, initial system, capital planning, board process and internal capital management (including allocation and pricing) complexity should be manageable given the clear longer-term advantages of Approach 2. |
| Combination of Approach 1 and Approach 2 | Although advantages are similar to Approach 2 the impact will be reduced as alignment to the Basel framework is only partially achieved. | Complexity<br>- A combination of Approach 1 and Approach 2 would result in higher complexity compared to Approach 2 as it would result in two sets of capital ratios. |

| | | |
|---|---|---|
| Approach 1: consistent disclosures | | Unfavourable for:<br>- Demonstrable relative strength.<br>- Capital raising – times of stress.<br>- Capital raising – deeper investor base. |
| Status Quo | | Unfavourable for:<br>- Demonstrable relative strength.<br>- Capital raising – times of stress.<br>- Capital raising – deeper investor base. |

**Q2. If APRA were to apply a combination of Approach 1 and Approach 2, which aspects of relative conservatism are best suited to be treated under Approach 2?**

The ABA recommends not applying a combination of Approach 1 and 2, as one of the key benefits of a modified Approach 2 is the production of a single APRA endorsed comparable ratio, rather than continuing with producing two ratios. The aspects of relative conservatism that we believe should be included in Approach 2 are all material areas of APRA super equivalence relative to the BCBS Basel III framework in terms of both definition of capital (including deductions) and calculation of RWAs.

**Q3. Are there alternative approaches to those outlined in Chapter 2 that APRA should consider?**

As outlined above, the key areas that we believe a more internationally consistent approach which still achieves APRA's objectives, and builds investor confidence in the capital ratio regime would be to:

- Keep the minimum CET1 ratio at 4.5 per cent in line with internationally agreed minimums.
- Maintain the Additional Tier 1 (AT1) trigger level at 5.125 per cent, consistent with the majority of international peers.
- Implement an AOA that captures APRA conservatism in RWAs and deductions and which forms part of the capital buffers rather than minimum requirements.
- Introduce a buffer that is adjusted in line with systemic risk build up. Positioning the buffer above the capital conservative buffer would improve transparency and flexibility, whilst still achieving APRA's desired capital outcomes.

**Q4. What are the material considerations in regard to the disclosure of adjustments to the capital ratio requirements under Approach 2? Should the level of disclosure of the adjustments be in aggregate only or also attributed to aspects of relative conservatism?**

The ABA recommend that the AOA be published as a single headline buffer, with a reconciliation of the components of the AOA produced, in a simple pre-defined format, as supplementary analysis in the Australian bank's investor disclosures and Pillar 3 reports. The components of the AOA would be APRA specified to enhance both the credibility of the published headline ratios and the consistency of disclosures between banks. This would fulfil the transparency goal of this proposal, and aid with investor education of the strength of capital base of the Australian banks.

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**Q5. Are there other implementation considerations that may arise with the approaches outlined in Chapter 2, such as costs in modifying systems and process for capital calculations or integration into ADI's strategic and capital planning cycles?**

The ABA has a strong preference for Approach 2 with modifications. The table below details implementation considerations related to Approach 2:

| Consideration | Description | Recommendation |
|---|---|---|
| AOA calculation and disclosures | - Regulatory judgement in setting of AOA may reduce transparency.<br>Additional onerous AOA disclosures may increase operational complexity. | - Calculations should be mechanical (similar to current RWA calculations) for simplicity.<br>- Mechanical calculations could flow directly into disclosure requirements.<br>Disclosure by each specific adjustment to improve transparency for stakeholders and comparability across domestic banks. |
| APRA standards alignment | - Misalignment across regulatory requirements, e.g., Leverage Ratio (APS 110), Large Exposures (APS 221) and Related Entity Exposures (APS 222) and NSFR (APS 210). | - Align capital measurement across all requirements.<br>- Recalibrate risk weights thresholds used in NSFR with Approach 2. |
| Redundancy of APRA requirements | - Adequacy judged solely on headline internationally comparable ratios which may be unfamiliar to the domestic investor base. | - Ongoing analyst and investor education and communication.<br>- Investor communication and education as joint initiatives by ADIs and APRA. |

**Q6. Are there alternative measures to mitigate the operational complexity under Approach 2?**

There are a number of measures which APRA can consider to improve transparency, simplicity and comparability and also reduce operational complexity in APRA's proposed Approach 2.

***Output floor***

An unintended consequence of the adoption of Approach 2 as proposed by APRA is that the 72.5 per cent floor to Standardised RWA may be unnecessarily triggered.

In principle, if Australian ADIs are currently holding sufficient capital for APRA's conservatisms under the A-IRB RWA approach, that exceeds the capital required for 72.5 per cent of the Standardised Approach, then the output floor should not be binding. The BCBS's intent of an output floor minimum was to reduce RWA variability, in particular to address outlier jurisdictions with abnormally low IRB risk-weights compared to Standardised risk-weights, which is not the case for Australia.

***Final calibration of Approach 2***

The February 2018 discussion paper made a reference to potential additional overlay adjustments required to meet the 'Unquestionably Strong' benchmark. It would be prudent to assess the uplift to APRA ratios and the mechanics of the AOA buffer based on APRA's final calibration of these Basel III reforms in Australia.

The ABA supports APRA's intention for an industry wide QIS to finalise calibrations for the Basel III revisions. A well-timed QIS on a settled framework is essential to ensure that the framework design for Approach 2 delivers the intended transparency, comparability and flexibility objectives, while maintaining the quantum of capital that meets APRA's 'unquestionably strong' targets.

In calibrating the final settings, the ABA recommends that APRA conduct an industry wide QIS followed by engagement with ADIs to ensure appropriate calibration of the capital framework, including the output floor application.

***Implementation***

The frequency of AOA buffer should be a periodic and a mechanical calculation.

There will have to be a change in current internal capital management (including allocation and pricing) and Board processes. Traditionally, Board/management capital ratio targets and minimums are set annually through the Internal Capital Adequacy Assessment Process (ICAAP). However, the ABA firmly believes the benefits will exceed the costs and resources required to make the change.

If Approach 2 is implemented, this will be a significant change from the current framework. As such, key external stakeholders (for example investors, bank research analysts, media and other peer regulators) will need to be educated on how the framework operates and how APRA's conservative regulatory settings have been retained. The ABA, ADIs and APRA would have a role to play in the successful adoption of the new approach.

**Q7. Would increasing the size of capital buffers (either by increasing the CCB or by setting a non-zero baseline CCyB) relative to PCR appropriately balance capital strength with financial stability through the cycle?**

Yes, revisions to the capital framework should seek to improve the resilience of the Australian financial system to withstand periods of stress. Capital buffers would provide more flexibility into the capital framework, given they increase the distance to automatic regulatory intervention and potentially mandatory distribution constraints without compromising on the total level of capital required. This extra distance provides supervisory flexibility when deciding on mitigating actions.

In using capital buffers, APRA yields none of the control they have today, but does gain increased capacity and time to determine appropriate actions in times of stress. The use of buffers further promotes financial system stability and helps to support continued market access to address any capital deficits in a more orderly and flexible way.

The distribution of ordinary dividends continues to be a critical component of an ADIs' overall strategy, and preserving this capability is important. Activation of limitations on dividend payments or Additional Tier 1 payments may result in limiting the ability of ADIs' to complete ordinary share capital raisings, the very transactions required restore the CET1 levels. Any capital buffer linked to potential constraints on dividend payments (whether above or within the CCB) represents a clear threshold not to be breached under the ordinary course of business.

As such, the ABA expects no material change in the way an ADI determines their risk appetite and the management buffers maintained to the top of total capital requirements, regardless of capital stack construction. Buffers can be easily adjusted and act as a lever to alter capital requirements as appropriate, creating capacity during periods of market stress. Variable buffers help to lean against the build-up of system-wide risk in periods of growth and can reduce the risk of constraining the supply of credit in downturns. This balancing mechanism also assists in stabilising the credit cycle and avoiding pro-cyclical impacts.

**Q8. What may be some of the potential impacts if APRA increase the prescribed loss absorption trigger above 5.125 per cent of RWA?**

As discussed in the main part of this submission, the ABA does not support the proposal to increase the prescribed loss absorption trigger above 5.125 per cent of RWA. Introducing a framework that achieves greater international comparability from an Australian bank CET1 perspective, however setting a more conservative AT1 trigger level is inconsistent with the approach to capital ratios and minimums more broadly under Approach 2.

We believe the key impacts if APRA increase the prescribed loss absorption trigger are as follows:

- Introduction of significant and unnecessary complexity into the capital framework;
- Activation of limitations on AT1 payments may result in limiting the ability of ADIs' to complete ordinary share capital raisings, the very transactions required restore the CET1 levels;
- A proposal outside of the internationally agreed framework would make marketing of Australian AT1 securities more difficult relative to international peers; and
- A higher trigger is likely to lead to wider pricing for Australian ADI AT1 securities, making Australian banks less competitive globally. Continuing to have access to a diverse funding base remains critical for the Australian ADIs reliant on offshore markets and therefore for the Australian economy.

end.