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TO: ALL AUTHORISED DEPOSIT-TAKING INSTITUTIONS

OPERATIONAL PREPAREDNESS FOR ZERO AND NEGATIVE INTEREST RATES

The Australian Prudential Regulation Authority (APRA) is today releasing its final expectations regarding ADIs' preparedness for zero and negative interest rates.

Background

The Reserve Bank of Australia has stated that a negative cash rate is highly unlikely in Australia. This, however, does not preclude the possibility of a negative cash rate in the future or of other interest rates determined in the financial markets falling to, or below, zero.

Prudential Standard *CPS 220 Risk Management* (CPS 220) requires an ADI to maintain a risk management framework to manage material risks. APRA considers the risks arising from an ADI's lack of preparedness for zero and negative interest rates to be material since this could have significant implications for an ADI's operations.

Accordingly, on 12 July 2021, APRA released for consultation its draft expectations regarding ADIs' preparedness for zero and negative interest rates. The draft expectations were that ADIs, at a minimum, develop *tactical solutions* to implement zero and negative market interest rates and cash rate by 30 April 2022.

The scope of APRA's draft expectations extended to all products and activities, except for lending products that do not reference the cash rate or a market rate including business lending, residential mortgages, personal loans and credit cards.

Submissions received

APRA received 14 submissions: 12 from ADIs and two from industry bodies.

ADIs indicated that they are well-positioned to deal with zero or negative interest rates by mid-2022, with submissions commenting on four aspects of APRA's draft expectations:

(i) In relation to deposit products, some submissions noted that implementing negative interest rates or fees on a large number of deposits through tactical solutions would increase operational risk;

(ii) Some ADIs requested an extension to the date proposed by APRA for developing tactical solutions;

(iii) APRA was requested to clarify that it only expected ADIs to prepare for negative interest rates on products where they would make a commercial decision to implement such rates; and

(iv) ADIs also requested clarity on the use of interest rate floors in lending products, and additional guidance on the level of preparedness expected by APRA.

Finally, a number of submissions noted that negative interest or additional fees would not be consistent with the definition of 'basic deposit products' in the *Corporations Act 2001* and queried whether ADIs needed to be prepared for the additional obligations that would apply as a result of this.

Final expectations

Consistent with APRA's draft expectations, APRA expects ADIs to, at a minimum, develop tactical solutions[1] to implement zero and negative market interest rates and cash rate.

APRA has made two changes to the draft expectations to account for the comments made:

(i) Customer accounts (including those of related parties) with an aggregate deposit balance of less than $10 million have been excluded from the scope of APRA's expectations[2], noting industry feedback that tactical solutions would increase operational risk due to the large number of customers involved[3]; and

(ii) APRA has extended the timeframe for development of tactical solutions to 31 July 2022, recognising the low likelihood of widespread negative interest rates in the near term.

In addressing the other comments, APRA notes the following:

- APRA recognises that ADIs may make a commercial decision not to implement zero and negative interest rates on certain products that are in scope for APRA's expectations. However, APRA expects ADIs to prepare for zero and negative rates on all products and activities that are in scope, given APRA's objective is to facilitate consistency in preparedness across the industry.

- Interest rate floors in lending products that reference the cash rate or a market rate are an acceptable solution. However, given the higher likelihood of negative interest rates on deposits of $10 million or more, APRA expects ADIs' preparations to extend beyond the use of zero interest rate floors on such deposits.

- In developing tactical solutions, APRA expects ADIs to pre-position themselves by 31 July 2022 in all relevant aspects of the products and activities that are in scope, including customer communications and disclosures. As a result of a deposit product no longer qualifying as a 'basic deposit product', additional requirements administered by ASIC may apply under the *Corporations Act 2001*. An ADI affected by this should pre-position itself to ensure compliance with the additional requirements.

- Following the development of tactical solutions by 31 July 2022, APRA expects ADIs to be able to implement the solutions within three months, if required.

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[1] Tactical solutions are typically shorter-term fixes, involving workarounds on the periphery of existing systems, along with overrides in downstream systems. Solutions that generate an economic outcome that is equivalent to a negative interest rate are acceptable, subject to the appropriate risk management considerations.

[2] Lending products that do not reference the cash rate or a market rate, including business lending, residential mortgages, personal loans and credit cards, remain outside the scope of APRA's expectations.

[3] ADIs should assess operational risks associated with tactical solutions and ensure there are appropriate controls in place to manage them. ADIs should also consider any relevant conduct-related issues, including the fair treatment of clients, asymmetry of information and potential for conflicts of interest.

Contact

ADIs requiring additional information should contact their responsible supervisor.

Yours sincerely,

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