20 August 2021

[redacted]
Australian Prudential Regulation Authority
Via email: [redacted]

Dear Mr [redacted]

Contingent Liquidity: Proposed Guidance

The Australian Banking Association (**ABA**) welcomes the opportunity to provide comment on the letter sent by the Australian Prudential Regulation Authority (**APRA**) on 14 July 2021, entitled *Contingent liquidity - Proposed Guidance.* This letter outlined APRA's intention to revise its guidance for self-securitised assets in Prudential Practice Guide APG 210 Liquidity to de-link this form of contingent liquidity from the Committed Liquidity Facility (**CLF**).

Our position

The ABA supports maintaining an excess reserve of eligible assets for contingent funding to ensure stability during periods of stress. However, we have concerns regarding the revised requirements as currently proposed by APRA. In particular:

1. **It is well-above international standards**

   The magnitude of the proposed requirements will result in authorised deposit-taking institutions (**ADIs**) needing to sustain a minimum liquidity coverage ratio (**LCR**) of 130 per cent, which is well above operating levels of banks globally.[1]

2. **It is proposed to include offshore operations**

   It is inappropriate to apply this requirement to Level 2 operations, as it implies the facilities provided by the Reserve Bank of Australia (**RBA**) in AUD should be used to cover liquidity exposures in other jurisdictions, other currencies and in other ADI legal entities. It also presumes that domestic operations should provide liquidity to support offshore operations (of both branches and subsidiaries) during stresses.

3. **It is to apply at all times**

   Throughout COVID-19, Australian ADIs have shown their ability to increase their levels of contingent funding within a short timeframe. Noting the proposed requirements will constitute an increase of approximately $200 billion of contingent funding to ADIs balance sheets and given the operational requirements and additional costs associated with self-securitisations, we do not consider the assets should be securitised at all times to obtain certainty of access to this reserve.

4. **An implementation pathway has not been proposed**

   Given the material increase in reliance on self-securitisation over the last 12 months due to the establishment of the Term Funding Facility (**TFF**), a transition period for the proposed requirement which considers the drawn TFF is essential.

The industry has set out several recommendations below aimed at resolving these concerns.

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[1] Setting the level at 30% of Level 2 Net Cash Outflows implies that APRA (and the RBA) would allow the contingent liquidity to be converted into a liquid asset under a stress scenario boosting an ADI's LCR from potentially dropping below 100% back to a level of >130%. Implying that banks should be operating a LCR of >130%. This is well above current Basel requirements.

Key recommendations

1. **The requirement should be below 30 per cent**

   The ABA recommends any super-equivalence with Basel standards should be carefully thought out and justified as it has impacts in terms of ADIs' options in accessing alternative sources of funding. It may also lead to ADIs relying on the RBA as the primary source of liquidity during periods of stress, creating a 'moral hazard' that may otherwise have been avoided if banks were able to access alternative funding sources.

2. **The requirement should apply only to domestic operations**

   The ABA recommends the requirement should be on an AUD Net Cash Outflow (**NCO**) basis, not an all-currencies NCO basis. This is consistent with the methodology used to calibrate other sources of contingent liquidity provided in the Australian banking system, including:

   - the size of the CLF limit, which is calibrated based on AUD NCO, and
   - the TFF Initial and Supplementary Allowances, which was calibrated based on a percentage of Australian assets.

   We further recommend setting it as an average NCO set once per year as there will be challenges in calculating it on a daily moving yearly average.

3. **The requirement should not be ongoing, but rather specific to stress scenarios**

   APRA has indicated they have concerns around ADIs ability to top-up their internal residential mortgage-backed securities (**iRMBS**) in a timely manner. The ABA recommends APRA could alleviate this concern by strengthening its guidance on the specific timing required to top-up iRMBS. For example, ADIs could be required to demonstrate an ability to top up their iRMBS within a set period of time, with consultations undertaken on this timing with ADIs prior to finalising the guidance to ensure that unachievable and unnecessarily tight requirements are avoided.

4. **A transition period should be provided and aligned with TFF maturity dates**

   APRA has not provided an implementation date for this proposed guidance. Currently, most ADIs are at the peak of mortgage utilisation for self-securitisation due to the establishment of the TFF. A transition period which aligns the increase in contingent liquidity reserve requirement with the key TFF maturity dates of 30 September 2023 and 30 June 2024 is recommended. The ABA recommends APRA should engage with the RBA to coordinate the timing, size and scope of these expectations.

In addition, the ABA has set out several other considerations and points of clarification in Appendix A.

Thank you for the opportunity to provide feedback. If you have any queries, please contact me at [redacted]

Yours sincerely,

[redacted]

[redacted]

Associate Policy Director

Australian Banking Association

Appendix A: Other considerations

Collateral for the contingent liquidity reserve should not be limited to self-securitisation

Consistent with the principles of the CLF, self-securitised assets remain the most appropriate category of collateral and are expected to contribute most of the contingent liquidity reserve. However, to facilitate management of variations in availability and requirement for self-securitised collateral, an ADI should be able to use alternative CLF-eligible collateral to meet its contingent liquidity reserve.

Timing of changes to CLF levels

APRA has advised some members that CLF levels will be reviewed in Q4 of 2021. To the extent that CLFs are likely to change following this review, this will impact the collateral available to ADIs to apply to the buffer that APRA is proposing, the size of the self-securitisations, and the aggregate amount of contingent liquidity held by the ADI. Therefore, the requirement for a buffer and any transitional arrangements should be effective at the same time as CLF allocations are amended.

Co-ordination with the RBA

The RBA applies several haircuts when calculating the amount of cash that it will lend under repo to an ADI under its CLF. These are in addition to the requirements that the ratings agencies use when assigning AAA status to these securities. This applies when a related party provides facilities such as a bank account, basis swap and interest rate swap. In the case of interest rate swaps, there is a step change in the haircut if the swap exceeds 50 per cent of the pool of loans. Given the greater emphasis being placed on the cash that can be generated from self-securitised loans, we ask APRA to enquire with the RBA whether it is amenable to reviewing these haircuts.

Clarification

APRA's letter refers to “surplus self-securitised assets”. We would like to clarify that “surplus” is defined as assets more than those which would be required to collateralise an ADI's CLF, taking in to account that an ADI may have other repo-eligible securities which could partially collateralise its CLF.

For example, if an ADI had:

- CLF of $100
- third party repo-eligible securities with a cash value of $40, and
- self-securitisation securities with a cash value of $120

is the surplus self-securitised asset value = $120 - ($100 - $40) = $60?