DISCUSSION PAPER

Post-implementation review of the Basel III liquidity ratios in Australia

3 March 2022

Contents

Executive summary

The Basel III liquidity reforms were introduced eight years ago in Australia, with the commencement of the revised *Prudential Standard APS 210 Liquidity* (APS 210) in 2014. The two core measures of the reforms, the Liquidity Coverage Ratio (LCR) and the Net Stable Funding Ratio (NSFR), became effective from 2015 and from 2018 respectively.

The revised standard for liquidity aimed to:

- address deficiencies in previous liquidity frameworks;
- align APRA's liquidity regime with international best practice; and
- reduce the likelihood of the need for (and degree of) government intervention or support for Authorised Deposit-taking Institutions (ADIs) in any future financial crisis.

The Basel III liquidity reforms were important in reinforcing financial safety and system stability, requiring higher standards for bank liquidity management to address weaknesses that emerged internationally during the global financial crisis (GFC).

Given the significance of these reforms, APRA is undertaking a post-implementation review (PIR), focusing on the core measures of the LCR and NSFR. The outcomes of the PIR will be used to inform a broader review of APRA's liquidity requirements, scheduled for 2023.

Objectives of the review

The purpose of the PIR is to assess the impact of the LCR and NSFR, and understand the costs and benefits of the measures. Consultation with key stakeholders is an essential part of the process.

APRA is seeking feedback from relevant stakeholders on:

- benefits to financial safety and system stability;
- compliance costs (upfront and ongoing);
- commercial costs (such as impacts on the cost of funding); and
- the impacts on competition.

The feedback gained through the PIR will inform potential adjustments to the LCR and NSFR and, is the first step in the broader review of APRA's liquidity requirements which will culminate in a refresh of APS 210 next year.

Next steps

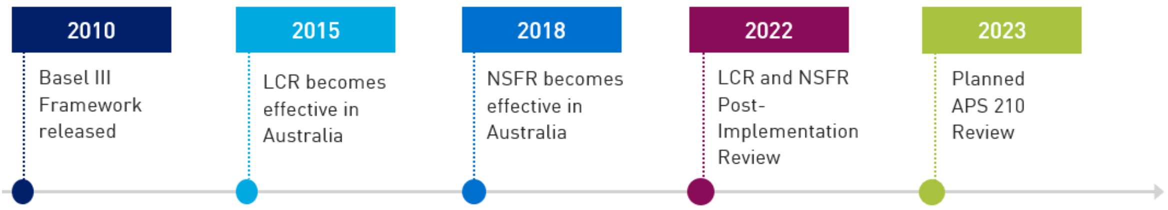
Stakeholders are invited to provide written submissions in response to this discussion paper by 14 April 2022. Over the course of the PIR process, APRA also plans to undertake roundtable discussions and bilateral meetings with key stakeholders. APRA intends to release a report on the outcomes of the PIR by mid-2022.

Chapter 1 - Background

The GFC revealed substantial weaknesses in the management of liquidity risks by banks internationally.[1] Funding market liquidity dried up over 2007-2009, which placed significant pressure on the banking system domestically and overseas, requiring government intervention and support in many jurisdictions. Following the GFC, there was a global move to strengthen the liquidity risk profile of banks.

Basel III liquidity reforms

In December 2010, the Basel Committee for Banking Supervision released an international framework for liquidity risk measurement, standards and monitoring: the Basel III liquidity reforms. APRA introduced these requirements through revisions to the prudential standard for liquidity, APS 210, which included the LCR and NSFR measures.[2] A summary timeline for the implementation of the Basel III liquidity reforms is outlined below.



As noted in APRA's regulation impact statements (RIS) during the original consultations on APS 210, the reforms aimed to:

- address deficiencies in the previous liquidity framework, both qualitative and quantitative, which were highlighted by the more extreme phases of the GFC in 2007-2009;
- align APRA's liquidity regime with international best practice, maintaining the high international reputation of the Australian financial system and helping to ensure that funding markets stay open to ADIs; and

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[1] Liquidity risk is the risk of being unable to meet obligations as they come due, without incurring unacceptable losses. Banks are inherently vulnerable to this risk given their role in the maturity transformation of short-term deposits into long-term loans.

[2] The Basel Committee has subsequently assessed the LCR and NSFR regulations in Australia and concluded them to be compliant with the Basel III standards. See Regulatory Consistency Assessment Programme (RCAP) - Assessment of Basel III LCR regulations - Australia (bis.org) and Regulatory Consistency Assessment Programme (RCAP) - Assessment of Basel NSFR regulations – Australia (bis.org)

- reduce the likelihood of the need for (and degree of) government intervention or support for ADIs in any future financial crisis.[3]

APS 210 applies to all ADIs in Australia. It covers both qualitative and quantitative requirements for liquidity risk management. Fourteen domestic ADIs are currently subject to the LCR and NSFR, and an additional 42 foreign bank branches are subject to the LCR.

LCR and NSFR

The LCR and NSFR are complementary measures, focusing on short-term and longer-term resilience. An overview of the measures is set out below.

Table 1. Overview of the LCR and NSFR measures

Measure	Intended objectives	Definition
LCR	The LCR is intended to promote short-term resilience of a bank's liquidity profile by ensuring that it has sufficient high-quality liquid assets to survive a significant stress event lasting for one month.	The LCR requires banks to hold high-quality liquid assets at least equal to an estimate of short-term net cash outflows under a stress scenario, to build resilience to liquidity shocks.[4]
NSFR	The NSFR is intended to promote longer-term resilience in a bank's funding profile through requiring more stable sources of funding on an ongoing basis.	The NSFR requires banks to maintain an amount of available stable funding at least equal to their required stable funding, to promote sustainable funding structures.

Given the significance of the reforms, APRA is undertaking a PIR on the LCR and NSFR measures. The PIR will also inform the scope of a planned review and update of APS 210 in 2023.

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[3] See *RIS Basel III liquidity reforms in Australia* (December 2013) and *RIS: Basel III liquidity: the net stable funding ratio and the liquid assets requirement for foreign ADIs* (December 2016), Regulation impact statements | APRA

[4] For a foreign bank branch, the LCR value must be at least equal to 40 per cent.

Chapter 2 - Post-implementation review

Purpose of the PIR

The purpose of the PIR is to determine how effectively and efficiently the LCR and NSFR are achieving their objectives. The PIR will explore the impacts of the measures, and determine whether a net benefit has been achieved in implementation.

APRA is seeking stakeholder feedback on the impact of the LCR and NSFR, and specifically:

- benefits (for financial safety and system stability);
- compliance costs (upfront and ongoing);
- commercial costs (such as the impacts on the cost of bank funding); and
- impact on competition.

The PIR will be conducted in accordance with the approach set out in the Office of Best Practice Regulation (OBPR) guidance.[5] APRA intends to publish the outcomes of the PIR in June 2022.

Scope

The scope of the PIR is limited to an assessment of the LCR and NSFR liquidity measures. APRA's prudential standard for liquidity, APS 210, also includes other requirements and reporting obligations that are beyond the scope of this review.

Details on the LCR and NSFR are specified in the following parts of APS 210. In addition, APRA has provided prudential guidance and reporting definitions in *Prudential Practice Guide APG 210 Liquidity* (APG 210) and *Reporting Standard ARS 210 Liquidity* (ARS 210).

Table 2. LCR and NSFR metrics

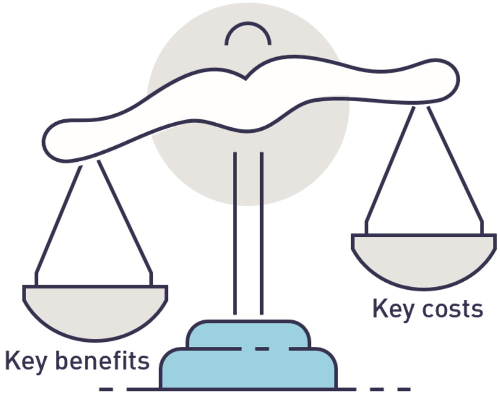
Framework	Summary	Reference
Prudential Standard APS 210	Sets out calculations, definitions and operational requirements for meeting and maintaining the LCR and NSFR.	APS 210: Attachments A and C
Prudential Practice Guide APG 210	Provides guidance and best practice recommendations for meeting the requirements set out in APS 210.	APG 210: Chapters 2 and 4
Reporting Standard ARS 210	Requires ADIs to provide APRA with certain information on the LCR and NSFR.	ARS 210: Reporting forms 210.1A, 210.1B and 210.6

[5] See *Guidance Note: Post-implementation reviews*, Post-implementation Reviews Guidance Note (pmc.gov.au)

Benefits and costs: original analysis

As part of the consultation undertaken when implementing the Basel III liquidity reforms, APRA published a RIS for both the LCR and the NSFR. The LCR and NSFR were assessed by APRA to provide estimated net benefits. The key offsetting benefits and costs are summarised below.

- Greater resilience to liquidity problems for entities and system
- Reduced likelihood of government intervention or support
- Better access to international markets



- Initial and on-going compliance costs
- Higher funding costs due to balance sheet management changes
- Other potential impacts

APRA undertook analysis of the potential compliance costs in the RIS. At a high-level, compliance costs based on industry estimates are outlined below, together with APRA's estimates of the potential impact of the cost of holding additional liquid assets and longer-term funding. More detailed analysis is provided within the LCR RIS and NSFR RIS.

Table 3. LCR and NSFR cost analysis

Measure	Compliance cost estimates	Funding cost estimates
LCR	For the LCR, the actual implementation costs for the industry were estimated to be $50.5m per year averaged over a 10-year period. For an average major bank, this included: • $24m as a one-off upfront cost of liquidity systems and framework enhancements; and • $5m per annum as ongoing compliance costs.	At the time of implementation, ADIs were expected to hold an additional 11 per cent of their balance sheet as liquid assets compared to pre-GFC. Of this, APRA assumed 5 per cent related to the new requirements (the remainder would have happened in the absence of reforms). If the carrying cost of this change was recovered by repricing the rest of the asset book, APRA estimated the cost to be around 3 basis points.
NSFR	For the NSFR, the actual implementation costs for the industry were estimated to be $2.4m per year averaged over a 10-year period.	The impact on the cost of funding as a result of changes to funding profiles from implementing the NSFR was estimated to be 40-45 basis points for the major banks and 75-80 basis points for regional ADIs.

Chapter 3 - Consultation and next steps

Consultation questions

APRA is seeking responses from stakeholders on the following consultation questions, with supporting analysis and evidence where possible.

Table 4. Key questions

Topic	Questions
Meeting the objectives	1. Have the LCR and NSFR achieved their intended specific objectives (as set out in Table 1), and supported the overall objectives of the Basel III reforms? 2. Are there areas where the prudential and reporting framework for the LCR and NSFR could be improved to better achieve the intended objectives?
Impacts of the measures	3. What have been the benefits of the LCR and NSFR to financial safety and system stability, and how can these be quantified? 4. What have been the upfront and ongoing compliance costs (actual implementation costs)? 5. How did these compare with your ADI or APRA's original estimates? 6. What have the commercial costs of the LCR and NSFR been, including the impact on the cost of bank funding? 7. What has been the impact on competition from the LCR and NSFR?
Other feedback	8. Was there sufficient implementation time for the LCR and NSFR? 9. Is there any other additional feedback you would like to provide on the LCR and NSFR?

APRA invites written submissions to the consultation questions above. Submissions should be sent to ADIpolicy@apra.gov.au and addressed to the General Manager, Policy, Policy and Advice Division, APRA.

Measurement of costs

Compliance costs are defined as direct costs to businesses of performing activities associated with complying with government regulation. Specifically, information is sought on changes to compliance costs incurred by businesses as a result of APRA's proposals.

Consistent with the Government's approach, APRA will use the methodology behind the Regulatory Burden Measurement tool to assess compliance costs. This tool is designed to capture the relevant costs in a structured way, including a separate assessment of upfront costs and ongoing costs. It is available at https://rbm.obpr.gov.au/.

APRA requests that respondents use this methodology to estimate costs to ensure the data supplied to APRA can be aggregated and used in an industry-wide assessment. When submitting their costs assessment to APRA, respondents should include any assumptions made and, where relevant, any limitations inherent in their assessment. Feedback should address the additional costs incurred as a result of complying with APRA's requirements, not activities that entities would undertake regardless of regulatory requirements in their ordinary course of business.[6]

Timing

A timeline for the PIR is outlined below. Responses to the Discussion Paper are requested by 14 April 2022. In addition, APRA will be engaging with stakeholders through roundtable discussions and bilateral meetings over March-April 2022. If you are interested in meeting with APRA, please contact ADIpolicy@apra.gov.au by 25 March 2022. APRA intends to publish the outcomes of the PIR in June 2022.

March

- This Discussion Paper

March – April

- Written submissions
- Roundtable discussions
- Formal and informal bilateral meetings

June

- Release of outcomes of Post-Implementation Review

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.

[6] In APRA's NSFR RIS, the baseline scenario was an implementation of the Basel III liquidity reforms with no adjustments in Australia. Given that that international compliance would be expected as part of business as usual, regulatory compliance costs in the baseline scenario were zero, with other options incurring costs in excess of this baseline scenario.