

## Summary

NAB welcomes the opportunity to participate in APRA's Post Implementation Review of the Basel III liquidity ratios in Australia. NAB believes that a review of APS210, APG210 and ARF210 is timely and presents opportunities to improve the efficiency and effectiveness of the regime without compromising the benefits achieved through its implementation.

Key areas where NAB believes there is opportunity for further benefit include:

- Improving the interplay between buffers and resilience; and
- Improving alignment with international prudential liquidity regimes while acknowledging specific aspects of the Australian financial system; and
- Reorganising APS210 requirements, expectations, recommendations, and guidance.

### **1. Have the LCR and NSFR achieved their intended specific objectives (in Table 1), and supported the overall objectives of the Basel III reforms?**

NAB believes the LCR and NSFR metrics have addressed deficiencies in previous liquidity frameworks and aligned APRA's liquidity regime with international best practice. This is evidenced by:

- The need for government intervention has been reduced with increased levels of HQLA improving ADI resilience to stress events, increasing protection for depositors, and extending bank survival horizons.
- Balance sheets are stronger due to the significant increase of stable funding following the introduction of NSFR, further supporting debt investor confidence.
- APS210 has driven higher standards of governance covering liquidity risk management process, controls, and measurement along with increased focus from Boards and management.

While the objectives of the Basel III reforms have been largely met, these reforms introduce new challenges and risks, with these evident during the COVID-19 stress in 2020 and to a lesser extent during the macro environment challenges of 2022. These are touched on below.

### **2. Are there areas where the prudential and reporting framework for the LCR and NSFR could be improved to better achieve the intended objectives?**

NAB believes there are a number of areas where the prudential and reporting framework could be improved to better achieve intended objectives while also dealing to those new risks and challenges facing LCR ADIs. These include:

#### *Limited use of liquidity buffers*

The reluctance to use liquidity buffers is likely to create the expectation from management, the investor community and regulators that ADI's liquidity holdings must be always maintained and cannot be used for their intended purposes; that is to meet unexpected outflows. In turn this practice increases pressure on bank funding capacity and places greater reliance on wholesale markets, particularly during periods of volatility.

This behaviour is likely inconsistent with the objective of reducing ADI reliance on less stable sources of funding. The Prudential Regulation Authority recently published a [discussion paper<sup>1</sup>](#)

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<sup>1</sup> *The prudential liquidity framework: Supporting liquid asset usability*, Bank of England, (2022)

acknowledging this concern and the opportunity cost of holding excess liquidity which could otherwise be deployed to support the economy.

To encourage ADIs to utilise liquidity holdings APRA could identify and describe circumstances during which buffers could or should be utilised and/or allow LCR and NSFR to fall below 100%.

### ***Ongoing calibration of APS210 to reflect changes in the Australian financial system***

Compliance with APS210 has relied on the Committed Liquidity Facility (CLF), with the size of approved CLFs calibrated to system wide cash outflows. The CLF supported a liquidity shortfall driven by factors unique to Australia, such as the limited supply of HQLA and smaller structural deposit balances in the financial system.

The unwind of the CLF creates demand for both funding and HQLA in equal parts. LCR ADIs need to access ~A\$100-130bn of funding in 2022 to replace the CLF which is expected to require ADIs to increase exposure to offshore short term funding markets or alternatively use stable funding sources that would otherwise be available to support credit growth.

Although the removal of the CLF aligns Australian prudential regulation with international liquidity frameworks, it is also likely to:

- Place greater reliance on wholesale funding markets (likely offshore); and
- Impact the functioning of the Corporate bond market in Australia by reducing the demand and market liquidity of securities previously eligible for the CLF.

The withdrawal of the CLF has also occurred with limited broader consideration of measurement differences between APRA and international peers. These differences and their impacts presents an opportunity to:

- Review the conservatism built into the Australian liquidity measurement framework to alleviate the risks above; and
- Recognise the limited structural supply of funding available to ADIs and recalibrate the outflow assumptions associated with this funding to ensure stability and resilience can be maintained over the longer term.

### ***Further alignment of APRA's liquidity regime with international frameworks while recognising jurisdictional differences***

Superannuation deposit outflow rates do not reflect the stable nature of these deposits:

- Superannuation cash deposits are stable at the system level however attract 100% LCR outflows when held in 'at call' deposits.
- For every \$100 of superannuation at call deposits, LCR ADIs require approximately \$125-\$130 of HQLA (to meet 100% LCR compliance plus buffers).
- The additional \$25 drives reliance on offshore short term money markets (given limited domestic funding sources are available) and increases the costs to ADIs of holding superannuation money.

Recognition of Covered Bonds (CB) and Residential Mortgage Backed Securities (RMBS) as HQLA2 would level the playing field with global peers and promote liquidity in the Australian bond market:

- This would improve the funding capacity of LCR banks while alleviating the reduced liquidity of the non-HQLA market as a result of the unwind of the CLF; and
- Smaller issuers of CB and RMBS would likely benefit from the support provided to the non-HQLA market as a whole; and
- The asset class would receive a consistent regulatory treatment across jurisdictions.

Removal of the Australian dollar prudential LCR requirement

- Offshore funding is used to support LCR buffers primarily due to constrained sources of domestic short-term funding.
- The ability to hold liquidity buffers in the currency in which the outflows occur would reduce ADI costs, mitigate currency risk, reduce exposure to foreign exchange markets while providing ADIs with greater diversity of HQLA to invest in.

Additional reforms could include:

- Reducing the run-off rate for retail less stable deposits to 25% to align with global regulators including Canada, the UK and USA; and
- Adopting discretionary treatment of derivative stable funding requirements, in line with regulators in Canada, the US and Europe (from 20% to 5%).

### ***Streamlining reporting requirements with a focus on consistency in application of rules***

Consistent interpretation and implementation across ADIs is critical to ensure a competitive market for financial services while improving investor ability to assess liquidity risk:

- Greater clarity with respect to prudential interpretation will improve the consistency and transparency of reporting across ADIs.
- Streamlining of information across reporting forms will reduce complexity and reduce further risk of inconsistent reporting across ADIs.
- Finalisation of the definition of operational deposits will improve customer experiences and ensure consistent product offerings between banks.
- Timely alignment of liquidity standards with other prudential reporting (such as Risk-Weighted Assets) during periods of regulatory change and/or revisions to existing standards.

### ***ARF210 reporting requirements could be rationalised and remain effective***

The ARF 210 reporting forms are overly complex and collect large volumes of data, some of which is not used in the measurement of liquidity risk. The information collected is also not provided on an aggregated basis to ADIs as part of APRA's reporting. Opportunity exists to reduce the unnecessary complexity from the ARF210 reporting suite, allowing ADIs to focus on the more pertinent aspects of the prudential framework.

## **3. What have been the benefits of the LCR and NSFR to financial safety and system stability, and how can these be quantified?**

The benefits of the LCR and NSFR to financial safety and system stability are evident in ADI balance sheets and improved resilience to periods of systemic stress. These benefits can be quantified through:

- Australian ADI credit ratings (noting that capital strength is also a large factor here); and
- Balance sheet strength metrics including the percentage of ADI lending funded via customers and term wholesale funding;
- Other liquidity metrics such as 'survival horizon' timeframes; and
- Continued access to term wholesale funding markets (although there has not been any evidence of increased funding capacity for Australian ADIs)

## **4. What have been the upfront and ongoing compliance costs (actual implementation costs)?**

NAB has used best endeavours to determine compliance costs:

- Upfront costs include program staff, liquidity model build-out and liquidity transfer pricing capability.
- Ongoing compliance costs include staff and systems charges.

Differentiating the costs of managing liquidity risk more generally from the costs of complying with the prudential framework outlined in APS210 is challenging. For the purposes of this exercise NAB has used 50% of staff costs and 100% of average systems costs over the past 5 years.

## **5. How did these compare with your ADI or APRA's original estimates?**

NAB's estimate of compliance costs are broadly in line with APRA estimates.

## **6. What have the commercial costs of the LCR and NSFR been, including the impact on the cost of bank funding?**

Specific drivers include:

- The cost of materially higher term wholesale funding volume and tenor transformation in the lead up to NSFR.
- The cost of building tenor into deposits where investor preference may be for 'at call' products.
- The cost of holding buffers significantly above regulatory liquidity compliance levels.
- Increased exposure to offshore short-term funding markets due to limited sources of domestic funding available to support the phase-out of the CLF.
- Reduced liquid asset yield and more concentrated HQLA holdings due to lack of diverse HQLA options.
- The cost of capital incurred from holdings investments in semi government securities.

## **7. What has been the impact on competition from the LCR and NSFR? Other feedback**

NAB notes the following impacts on competition:

- Demand for non-HQLA securities may be negatively impacted through withdrawal of the CLF. Reduced appetite for these securities may impact both the funding capacity and cost of funding for non-banks issuers further reducing the availability of stable sources of domestic funding, and an increasing reliance on offshore investors for large LCR ADIs.
- LCR and NSFR are more favourable to ADIs retail customer assets and deposits compared to business customer bases through lower liquidity run-off rates, higher stable funding rates on retail deposits, and lower required stable funding rates on mortgages. This may result in more bank competition and investment in consumer banking at the expense of the business banking sector, which is essential for growth in productive capacity.

## **8. Was there sufficient implementation time for the LCR and NSFR?**

The timelines for the initial implementation of LCR and NSFR in Australia were in line with Basel expectations albeit materially shorter than those adopted in other jurisdictions, particularly for NSFR. The long-dated transition timelines were reasonable, supported by a clear consultation processes with regulatory responses to issues raised. The implementation of the CLF supported both the LCR and NSFR metrics and was well understood and communicated to stakeholders. In contrast, the removal of the CLF was communicated via an industry letter on 10 September 2021 with the expectation that compliance be maintained by 31 December 2021.

Material changes to the liquidity profiles of ADIs resulting from decisions such as this would benefit from a similar consultation process and transition timeline to provide Boards and investors greater time to digest changes whilst also allowing for operational process and controls to be implemented or updated.

## **9. Is there any other additional feedback you would like to provide on the LCR and NSFR?**

Whilst the LCR and NSFR have served the Australian financial system well NAB believes now is an opportune time to review and recalibrate the assumptions underpinning the metrics to ensure they remain fit for purposes over the medium term.

Given the significance of the structural changes underway in the financial system, commencing this review as soon as possible would be valuable to ensuring the LCR and NSFR continue to meet their objectives while also ensuring ADI's remain resilient and are able to continue to support the Australian economy post-COVID. None of the opportunities identified by NAB are material individually however collectively will guarantee resilience of ADIs is maintained while also ensuring the ability to support ongoing credit growth.