Australian Banking Association

Removing Additional Tier 1 Capital from the Prudential Framework

APRA

19 September 2025

Australian Banking Association

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Key Recommendations

- Basing the leverage ratio on CET1 rather than Tier 1 would result in a significant tightening of leverage ratio settings, which could lead to less risk-based decision making and potential impacts on lending, particularly in times of stress. We therefore recommend that the minimum leverage ratio requirement be reduced by 50bps to 3.0 per cent.
- APS 221 *Large Exposures* limits should be appropriately adjusted to maintain existing capacity. This could be achieved by removing key differences with the Basel Large Exposures framework. This would ensure all banks can continue to support lending across the Australian economy.
- We recommend APRA consider the capital options recently published in the Reserve Bank of New Zealand (RBNZ) consultation paper *2025 Review of key capital settings: Policy proposals for feedback* published on 25 August 2025 (RBNZ Consultation Paper) when finalising the prudential standards. The ABA has made some high-level observations in this submission about where the RBNZ proposals, including around internal Tier 2 and loss-absorbing capacity (LAC), bail-in and crisis management, will be relevant to APRA's proposals.
    - We recommend a change be made to APS 111 to facilitate the treatment of internal Tier 2 and LAC instruments using the "corresponding deduction approach" by the Australian parent.
    - The potential impact on Trans-Tasman limits should also be considered, given the proposal to move from Tier 1 to CET1 for the exposure limits.
    - The ability to structure instruments with either write-off or conversion as the primary loss-absorption mechanism should be retained, given the potential benefit of flexibility should such instruments become eligible as RBNZ capital in New Zealand.
- While the ABA appreciates the simplicity that APRA's proposed amendments are intended to bring, retaining a central definition of "Additional Tier 1 Capital" would provide clarity, particularly during the transitional period, and would support the terms of capital instruments which use this definition.
- The ABA also continues to recommend that APRA consider a more internationally-consistent approach to qualifying LAC by allowing a wider definition of alternative qualifying instruments. It should consider making a distinction between Tier 2 instruments held to meet the 3.25 per cent prudential capital requirements and the excess held for LAC purposes.

Policy Lead: [redacted]

About the ABA

The Australian Banking Association advocates for a strong, competitive and innovative banking industry that delivers excellent and equitable outcomes for customers. We promote and encourage policies that improve banking services for all Australians, through advocacy, research, policy expertise and thought leadership.

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ABA submission to APRA

The ABA welcomes APRA's continued consultative approach throughout its process of reviewing the role of Additional Tier 1 (AT1) capital in the prudential framework. In keeping with its previous submissions, the ABA notes APRA's concerns and its decision to remove these instruments from the framework. A careful approach to implementing this decision and making proposed changes to the prudential standards is vital to ensure the transition takes place with minimal disruption and without materially relaxing or unnecessarily tightening existing settings, consistently with APRA's objectives.

The ABA notes the release of the RBNZ Consultation Paper. The ABA has made some high-level observations in this submission about where the RBNZ proposals, including around internal Tier 2 and LAC, bail-in and crisis management, will be relevant to APRA's proposals. We encourage APRA to consider the implications of the RBNZ proposals as it finalises the AT1 changes and to make supportive amendments to Australian standards where appropriate, to facilitate a 'single point of entry' (SPE) approach to crisis management and support an ADI's ability to resolve its NZ banking subsidiary.

Key issues

The ABA has reviewed the changes APRA proposes to make to each of the relevant prudential standards. In developing the positions set out in this submission, the ABA's focus has been on ensuring the proposed amendments are accurate, are likely to be effective to achieve APRA's objectives, and are directly responsive to the reasons for APRA's decision to remove AT1 from the framework.

APS 110 – Leverage ratio

The ABA has the following concerns with APRA's proposal to base the leverage ratio on CET1 and maintain the minimum ratio at 3.5 per cent.

- The amount of headroom to the minimum leverage ratio requirement is significantly reduced from current requirements. This could result in the leverage ratio, rather than risk-based capital ratios, becoming the driver of business decisions in a normal operating environment, rather than operating as an intended "backstop" measure. This could have the following consequences:
    - potentially less risk-based decision making;
    - potential lending constraints, given there is a disincentive to continue lending in low-risk asset classes such as residential mortgages; and
    - increased complexity.
- The proposed leverage ratio calibration could lead to an inability to use CET1 buffers (such as the countercyclical capital buffer) in a period of stress if the leverage ratio becomes binding before buffers are fully utilised.
- Breach of the leverage ratio in stressed market conditions becomes more likely, particularly when accounting for system growth over the medium term.
- Breaching the leverage ratio would result in a breach of minimum requirements which could impact the ability of Australian banks to access offshore wholesale funding markets, increase wholesale funding costs and impede the ability to attract international capital.

On this basis, a reduction in the minimum leverage ratio requirement to 3.0 per cent would mitigate the above risks while maintaining a conservative requirement compared to international jurisdictions that measure the leverage ratio using Tier 1 capital.

Exposure Measure

APRA could also examine conservatism in the calculation of the Exposure Measure, for example the approach to central bank reserves. Increased central bank reserves have had the effect of lowering

leverage ratios despite not materially increasing an ADI's risk profile or RWAs, given the risk-free nature of those reserves.

As the RBA has moved from a system of scarce reserves, where AUD reserve balances fluctuated around AUD 10 billion, to ample reserves, where AUD reserve balances will end up around AUD 100 – 200 billion (an increase of around 10 to 20 times), this has reduced leverage ratios given the higher level of reserves within the system. As noted above, in the event the leverage ratio became binding, this could curb lending to the real economy. Some jurisdictions, for example the UK, permanently exclude central bank reserves.

APS 221 – Large exposures

The ABA reiterates the position outlined in its November 2024 submission, and in its email to APRA of 17 April 2025, that the removal of AT1 should not result in further restrictions elsewhere in the capital framework.

The reduction in the capital base by removing AT1 capital, without an offsetting recalibration of the limit, results in tighter large exposure limits and thresholds which may impact banks' ability to lend to the Australian economy. While the ABA appreciates APRA's intention for individual banks to coordinate with APRA on the changes, having a consistent approach across the industry that does not constrain banks' capacity to manage external lending exposures remains a key priority.

Recalibrating APS 221 limits based on CET1 introduces significant additional conservatism, particularly when considered alongside existing deviations from the Basel large exposures framework.

Currently, there are two areas where APRA's large exposures framework materially deviates from the Basel framework:

- Sovereign exposures: APS 221 currently limits certain government and central bank exposures unless they are held as High-Quality Liquid Assets (HQLA) under APS 210. This treatment is inconsistent with the actual risk and liquidity profile of these instruments, which are equivalent regardless of internal portfolio classification. The current approach creates unnecessary constraints and diverges from international peers.
- Structured Vehicle Look-Through (SVLT): APS 221 requires SVLT calculations on loan exposures to structured vehicles, unlike the Basel framework and offshore implementation which applies SVLT only to investments in collective investment undertakings. The current approach results in an overstatement of exposure, creating unnecessary constraints, produces counterintuitive outcomes and diverges from international peers.

To maintain international equivalence and ensure Australian banks can continue to lend in key sectors, we recommend targeted amendments to APS 221 to improve alignment with international standards, and to ensure APS 221 continues to reflect actual risk exposures in a proportionate and transparent manner.

Our suggested amendments, set out in Attachment A to this submission, are intended to:

1. Exclude all qualifying sovereign exposures
   Amend APS 221 to exclude all government or central bank exposures that meet the general HQLA eligibility criteria in APS 210, regardless of internal portfolio classification.
2. Remove SVLT requirements for loan exposures
   Eliminate the requirement to perform SVLT calculations on loan exposures to structured vehicles, aligning APS 221 with the Basel framework and offshore practices.

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Issues to be considered in the light of the RBNZ capital proposals

Resolution planning and the corresponding deductions approach

The ABA is supportive of a "corresponding deduction" approach for the treatment of internal Tier 2 and LAC instruments. Given APRA is currently amending APS 111, and in order to support the implementation of a "corresponding deduction" approach, the ABA requests that APRA also consider making a change to paragraph 9(f) of Attachment D by replacing references in that paragraph to "equity exposures" with "CET1 exposures".

Write-off as a primary loss-absorption mechanism

The ABA notes APRA's suggestion that its proposal to require Tier 2 capital instruments to be converted in the event of non-viability (paragraphs 1 and 2 of Attachment F to APS 111) is "to simplify the instrument for investors".[1] However, we are not aware of evidence that the optionality for banks to structure instruments with write-off as the primary loss-absorption mechanism creates, in practice, any complexity for investors, noting that write-off is a simple mechanism. Therefore, there does not appear to be a strong case for APRA to make this change.

The ABA supports the continued ability to structure Tier 2 instruments with either conversion or write-off as the primary loss-absorption mechanism, as currently permitted. While conversion is the prevailing structure in the Australian market, retaining the option for write-off is important for flexibility, particularly in the context of potential Trans-Tasman harmonisation. This is particularly relevant in the light of the RBNZ Consultation Paper, which may result in changes to the form of capital instruments permitted to be issued under its prudential framework.

Should the RBNZ allow write-off structures, retaining flexibility in APS 111 would enable the potential issuance of instruments that are compliant with both APRA and RBNZ frameworks, supporting alignment with any future developments in the New Zealand regime and facilitating cross-border issuance strategies.

Alternative qualifying LAC

APRA's solution for LAC is limited to one class of capital, requiring Tier 2 capital only for 7.75 per cent of RWA. The ABA continues to be concerned about this reliance on a single class of Tier 2 capital as the only source of LAC for ADIs.

The ABA continues to recommend that APRA introduce a distinction between Tier 2 instruments held to meet prudential capital requirements and those held in excess for LAC purposes. This approach could be implemented within the current capital framework, by requiring Tier 2 as currently defined for a minimum volume of 3.25 per cent to meet the prudential capital requirement, with the remaining LAC requirement to be satisfied by other qualifying LAC.

1. LAC-eligible instruments

   As noted in the ABA submission of November 2024, international peers can recognise LAC-eligible instruments in addition to Tier 2 (such as AT1 and forms of "Tier 3" debt (which may include NOHC debt, senior non-preferred debt)). In order to enhance access to LAC for the system, the ABA recommends a further review of the eligible LAC, including by expanding the flexibility in the capital framework and the sources of the additional LAC in the Australian banking system, for example by using structural subordination through NOHC issuance or permitting senior non-preferred debt.

   In order to promote the stability of the system through the cycle, policy should seek to maximise market capacity for Australian banks to obtain the additional LAC requirement in all market environments. This is particularly important given the proposal's current effect for Australian

[1] APRA, *Removing Additional Tier 1 capital from the prudential framework*, 8 July 2025.

major banks of concentrating 7.75 per cent of RWA in non-CET1 loss absorbing capital to Tier 2 only.

There is more that can be done to maximise the diversity of alternative investor bases, which is consistent with what has been implemented in many foreign jurisdictions and as a result ensure that Australian banks are not at a competitive disadvantage to global peers. More importantly, this should ensure Australian banks are better positioned to access LAC in all market environments.

2. Amortisation of Tier 2 instruments

   Similarly, the greater reliance on Tier 2 capital in the Australian context (and the potentially even greater reliance on Tier 2 in the light of the RBNZ proposal for a SPE resolution model for major NZ banks) puts Australian banks under significant pressure to replace instruments approaching maturity in order to maintain capital levels. We continue to encourage APRA to consider whether it is feasible for Tier 2 instruments to retain capital recognition for up to 12 months prior to maturity. Acknowledging that this point has been raised with APRA on multiple occasions in the past, members welcome engagement with APRA to discuss potential examples of how this could be achieved without requiring material changes to the prudential framework.

Trans-Tasman arrangements

The ABA welcomes APRA's recognition of the potential impacts of the changes on Trans-Tasman funding arrangements, and that APRA does not intend for there to be any additional restriction on these funding arrangements as a result of these changes.

While we also welcome that APRA intends to discuss the specific arrangements bilaterally with impacted entities, recognising the potential idiosyncrasies of each arrangement, we encourage APRA to consider what guidance or public commitments it can make to be transparent and consistent in its general approach across the sector.

The ABA encourages APRA to also consider the RBNZ proposals when determining the potential impacts of APRA's changes on Trans-Tasman arrangements. In particular, to the extent that the RBNZ's proposals (concerning internal Tier 2 and LAC, bail-in and crisis management to support an SPE approach) reduce the risks associated with exposures to NZ banks, this should prompt a reconsideration of the appropriateness of constraints on Trans-Tasman arrangements.

Holdings of AT1 capital instruments

ADIs with trading operations may hold a limited amount of AT1 capital instruments issued by Australian and offshore financial institutions. It is important that those ADIs are able to continue to provide market liquidity to issuers and investors to support the domestic capital markets (where the holdings are for trading and not for the purpose of inflating other regulated issuers' capital ratios). However, the change to require those holdings to become a CET1 deduction will result in the provision of liquidity becoming uneconomic and will have a detrimental impact on the ability of the Australian ADIs to make-a-market in those securities and to compete against offshore banks which can take advantage of a holding grace period and material thresholds beyond which AT1 holdings become deductible from their Tier 1 capital. This would result in an adverse outcome for the Australian financial system whereby offshore market-making banks could provide domestic market liquidity, but Australian market-making banks could not. This is especially important given the expectation from local and offshore issuers that the domestic ADIs would support the domestic capital markets and provide reasonable secondary market liquidity in AT1 instruments. The impact would be amplified in a stress environment if offshore banks no longer continue to support Australian issuers.

In most advanced offshore jurisdictions (for example, Japan and EU), only those AT1 capital holdings in another financial institution held in the trading book which exceed 10 per cent of the banks own CET1

are deducted from CET1. In addition, holdings of other financial institutions' capital instruments in the trading book (including a maximum holding period of 30 days) qualify for a separate deduction exemption if the gross long position does not exceed 5 per cent of its own CET1 threshold.

The ABA recommends APRA consider introducing an exemption from a CET1 deduction for the holdings of other financial institutions' capital instruments in the trading book if the gross long position of all AT1 instruments held there does not exceed 5 per cent of the trading bank's own CET1 capital and the maximum holding period of 30 days is not breached on an individual ISIN level.

Drafting considerations

A definition of "Additional Tier 1 Capital" should be retained. This would provide clarity particularly during the transitional period. To achieve this the ABA recommends that a standalone definition of "Additional Tier 1 Capital" be incorporated into CPS 001 (which could then be referenced to by other standards).

We note that the definition of "Additional Tier 1 Capital" is proposed to be removed entirely from CPS 001 *Defined Terms*, which currently refers to the also-to-be-deleted definition in APS 111 *Capital Adequacy: Measurement of Capital*. Instead of a definition, AT1 capital instruments are generally explained in footnotes.

Relying on footnotes in place of a central definition risks creating ambiguity and additional complexity, as in the following examples.

- Paragraph 3 of Attachment E to APS 111 refers to "Additional Tier 1 Capital instruments that meet the requirements of Attachment H", without having defined AT1 capital instruments except by a circular reference to Attachment H. This leads to ambiguity about whether paragraph 3 applies to all or only to some AT1 capital instruments. The ABA's understanding is that all outstanding AT1 instruments should be treated as transitional, but if that is not APRA's intention then a definition would allow APRA to clarify in what circumstances that would not be the case, resolving the potential for significant confusion.
- Similarly, uncertainty can arise where a footnote is missed. For example, APRA proposes a footnote to paragraph 12(b) of APS 111 to explain that AT1 capital instruments are treated as Tier 2. However, there are no similar footnotes to the previous reference to "Tier 2" in paragraph 10(a) of APS 111 or to the reference in paragraph 4 of Attachment A to APS 117, from each of which "Additional Tier 1 Capital" has been removed, leading to ambiguity over whether transitional AT1 instruments are intended to be "capital instruments" for the purposes of APS 111 or covered by APS 117.

Additionally, we note that some banks incorporate a definition of "Additional Tier 1 Capital" into their existing capital instruments by reference to the term as defined in APRA's prudential standards. Retaining a definition in the standard is important to avoid any uncertainty that the terms of existing instruments continue to operate with the same legal effect after the implementation of the changes on 1 January 2027.

APS 117 – Market-related items

Paragraph 4 of Attachment A to APS 117 (to be in force from October 2025) classifies all securities in the banking book as market-related items except for debt, AT1 and Tier 2 capital issued by the ADI. The marked-up version of the standard removes the reference to AT1. As the consultation paper notes, this is intended to reflect that "AT1 is now included in Tier 2".

In the transitional period, transitional AT1 instruments are to be included in Tier 2 for regulatory capital purposes. The ABA understands that this arrangement is intended to operate such that the reference to Tier 2 in Attachment A to APS 117 will be read as including transitional AT1 instruments. However, for

an abundance of certainty, we suggest this be stated explicitly in APS 117 to ensure there is no confusion that transitional AT1 instruments should be captured in the IRRBB calculation.

APS 330 – Simplification

The ABA considers that the proposed changes to APS 330 *Public Disclosure* could be simplified without compromising the intention of the changes.

Proposed paragraph 6 of Attachment A to APS 330 provides that references to Tier 1 Capital in the BCBS Standard are to be treated as references to CET1. While we support this simple approach, in practice it risks requiring unnecessarily duplicative reporting.

For example, on its face this wording would require ADIs to report CET1 capital and CET1 capital ratios against the Tier 1 capital and Tier 1 capital ratio row descriptions in the key metrics template KM1 (rows 2, 2a, 6, 6a and 6b) in addition to the rows that already refer to CET1 (rows 1, 1a, 5, 5a and 5b). We do not expect that that is APRA's intention.

An alternative approach to KM1, that avoids the duplicative reporting, would be for ADIs to omit the Tier 1 capital rows and report only the remaining capital ratios in APRA's revised framework.

Proposed paragraph 14 in Attachment A is clear on APRA's amendments to CC1 (the composition of regulatory capital template). We suggest paragraph 6 can be replaced with similar amendments to individual disclosures, such as the following:

- KM1 – an ADI is not required to disclose Tier 1 Capital or Tier 1 Capital ratios as part of key metrics;
- IRRBB1 – an ADI is required to modify the description of the row to report Tier 1 Capital to CET1 Capital in the BCBS quantitative information on IRRBB template, and disclose amounts in accordance with this modified description;
- LR1 and LR2 – an ADI is required to modify the references to Tier 1 Capital to CET1 Capital in BCBS leverage ratio disclosures, and disclose amounts in accordance with these modified descriptions.

APS 210 – Implications for net stable funding ratio

APRA has not advised of any proposed changes to APS 210 *Liquidity*. The ABA notes that Attachment C to APS 210 assigns available stable funding factors to liabilities including capital instruments for the purposes of the net stable funding ratio, with differential treatment for Tier 2 instruments with a residual maturity of less than one year. Given AT1 instruments will be captured as Tier 2 instruments from 1 January 2027, APRA should review this standard to ensure that the calculation of the net stable funding ratio is not unintentionally disrupted during the transitioning out of AT1 capital instruments.

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Attachment A: Recommended amendments to APS 221

Reference in draft APS 221	Proposed amendment
Paragraph 18(d)	exposures to governments or central banks ~~that are held as high-quality liquid assets under Prudential Standard APS 210 Liquidity (APS 210)~~;
Attachment A, paragraph 21	An ADI must calculate an exposure to a structured vehicle (e.g. funds, securitisation vehicles, structured finance products) which holds non-retail assets using the look-through requirements in paragraphs 22 to 26 of this Attachment, only when the ADI has an equity investment in the structured vehicle.
Attachment A, paragraph 22	Where an ADI's equity investment in ~~exposure to~~ a structured vehicle is less than 0.25 per cent of the ADI's Common Equity Tier 1 Capital, or the ADI can demonstrate that all the underlying assets of the structured vehicle are less than 0.25 per cent of the ADI's Common Equity Tier 1 Capital, an ADI must assign an exposure value to the structured vehicle equal to the nominal exposure it has to the structured vehicle. In this case, an ADI is not required to look through the structured vehicle to identify the underlying assets.
Attachment A, paragraph 23	Where an ADI's exposure value to at least one of the underlying assets of the structured vehicle is greater than or equal to 0.25 per cent of the ADI's Common Equity Tier 1 Capital, the ADI must assign an exposure value to the structured vehicle equal to the value of the ADI's equity investment in ~~nominal exposure it has to~~ the structured vehicle and:
Attachment A, paragraph 26	When an ADI has not applied the look-through requirements for an equity investment in ~~exposure to~~ a structured vehicle it must assess the risk concentrations of the underlying assets of the structured vehicle on an annual basis.
Attachment A, paragraph 28	An ADI must treat structured vehicles as a group of connected counterparties if they share one or more common additional risk factors that pose material risks to the ADI's equity investments in ~~exposures to~~ these structured vehicles.
Attachment A, paragraph 29	Where an ADI identifies more than one third party as a driver of a particular additional risk factor, the ADI must assign the equity investments ~~exposure~~ in the structured vehicles to each of the third parties if they pose material risks to the structured vehicles.

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Reference in draft APS 221	Proposed amendment
Attachment A, paragraph 30	An ADI must add its equity investments in ~~exposures to~~ a structured vehicle associated with a third party deemed to contribute to an additional risk factor to other exposures that the ADI has to that third party if: (a) there is a material risk to the equity investments ~~exposures~~ in the structured vehicle if the third party were to default on a direct exposure to the ADI; or (b) there is a material risk to a direct exposure to that third party if the third party were to default in its role in the structured vehicles.