



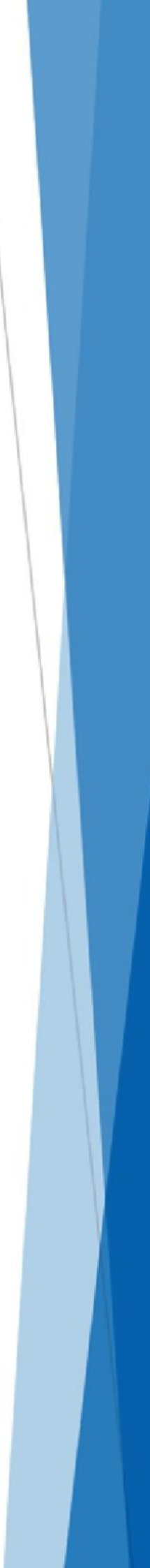
Australian Banking  
Association



# INTERNAL RATINGS-BASED ACCREDITATION

## Submission to APRA

19 December 2025





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## Key Recommendations

- The ABA welcomes APRA's proposals and broadly supports their implementation into the prudential framework. The changes recognise and address the pragmatic barriers to IRB accreditation without compromising on the high standard of risk management expected.
- APRA's expansion of permanent carve-outs to a broader range of circumstances is welcome; however, greater clarity in the prudential standard and explicit guidance on when a portfolio may be deemed immaterial, on the basis of its size and risk profile, would be beneficial.
- APRA should consider the appropriate application of the capital charge for interest rate risk in the banking book (IRRBB).
- APRA should outline its expectations for quantification of operational risks for newly IRB-accredited ADIs.
- The more guidance APRA can provide to applicant ADIs earlier in the accreditation process, the smoother the process will be and the lower the risk of wasted investment.
- We would welcome APRA's commitment to making accreditation decisions as soon as practicable once a final application is made.

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.

## ABA submission to APRA

The ABA welcomes APRA's consultation on a new pathway to internal ratings-based (IRB) accreditation for medium-sized ADIs. APRA's commitment, made in the Council of Financial Regulators (CFR) review of small and medium-sized banks, to a more transparent and flexible pathway will make it easier for medium-sized ADIs to make strategic decisions about whether to invest in advanced modelling capabilities and pursue the benefits of accreditation.

### Support for the new pathway

More transparency and flexibility in the IRB accreditation process is an appropriate way to facilitate greater take-up of IRB accreditation without reducing high expectations about ADIs' advanced approaches to risk and capital management. Accreditation, as the CFR observed, means improved assessment and management of risk and more accurate allocation of capital for risk. As IRB accreditation becomes a more realistic proposition for medium-sized banks, the benefits of that improved risk and capital management can be expected to expand across the banking system.

APRA's proposed improvements to the IRB accreditation process are appropriately directed towards facilitating accreditation without lowering standards or introducing risk into the system. Overall, they represent a pragmatic set of changes that should provide a clearer, more certain pathway for applicant ADIs to achieve accreditation, bringing with them those systemic benefits of stronger risk and capital management.

Since APRA last revised its IRB accreditation process, in 2015, only one ADI has achieved accreditation. A measure of the success of APRA's proposed new pathway will be whether more ADIs decide it is appropriate to make the substantial investments required to seek accreditation, and whether in fact more ADIs are ultimately accredited.

Consistent with our submission to the CFR review, the ABA strongly supports APRA's proposals for:

- flexibility to begin the accreditation process with a single credit portfolio (e.g. residential mortgages);
- allowing permanent carve-outs from the IRB approach in a broader range of circumstances; and
- fully realising capital benefits (and phasing-in of increased capital buffers) at each phase of the accreditation process.

These measures will provide ADIs with a more manageable and predictable pathway to accreditation, incentivising improvements in risk modelling to support APRA's prudential objectives.

Within the context of this overall support, the ABA has some suggestions for fine-tuning the approach and the timeline to ensure that the accreditation process runs smoothly and the phased-in benefits provide a clear incentive to potential applicants.

### Extent of IRB application within an ADI – carve-outs and portfolio selection

The ABA is encouraged by APRA's openness to allowing portfolios to remain on the standardised approach in more than just 'exceptional circumstances'. APRA's consultation paper gives the examples of portfolios that are in run-off, or immaterial in size, or where data challenges impede the development of credible models.

While APRA proposes to remove the reference to immateriality in draft paragraph 51 of APS 113 and specify that permanent partial use of the standardised approach is available in 'limited' rather than 'exceptional circumstances', this remains subject to there being a clear and achievable plan for bringing all other *material* portfolios under the IRB approach (draft paragraph 49). In practice, APRA's proposed changes may not therefore have the effect of broadening the circumstances in which a portfolio may be

permanently carved out beyond the immaterial threshold in the current version of paragraph 51, as paragraph 49 would require material portfolios in run-off or where data challenges exist still to be brought into the IRB approach. This ambiguity might be resolved by not making the change from 'significant' to 'material' in paragraph 49 and providing more detail on the circumstances in which a portfolio may be permanently carved out (including where a portfolio might be immaterial for reasons other than merely its size).

The ABA also welcomes the clarification that in a phased roll-out of an IRB approach a single portfolio can be selected in the initial phase. We note and support APRA's desire to avoid "cherry picking" in the selection of portfolios for approval. Draft paragraph 162(c) of APG 113 indicates that the initial portfolio(s) should cover the larger part of the ADI's aggregate credit exposures.

It may be that a hypothetical ADI's business is overwhelmingly in a single portfolio, to the extent that all other portfolios are either immaterial in size and risk or subject to data challenges or other rationales for permanent carve-out from the IRB approach. It is then at least in theory possible for an ADI, in those circumstances, to achieve final IRB accreditation after only one phase applied to only one portfolio.

Just as APRA has clarified that an ADI may begin the process with a single portfolio, it would be useful for APRA to clarify whether or not – in limited circumstances – it is possible for the process to end with that single portfolio. Further guidance on APRA's expectations around materiality and other criteria for permanent carve-outs would clarify the extent to which this is a possible outcome of the new pathway.

## Phased introduction of capital benefits and requirements

APRA's proposal to phase-in realisation of capital benefits along the pathway to full IRB accreditation is a significant positive step. Where previously a significant portion of the capital benefit would be deferred until final approval to provide an incentive to an ADI to complete accreditation, this welcome change recognises that an ADI has incentive enough, having made the decision to begin and invest in the process, to proceed to full accreditation.

Similarly, we welcome the phasing in of the increased capital conservation buffer under paragraph 27(b) of APS 110. Noting that the language of draft paragraph 163 of APG 113 frames this phase-in as discretionary, while the consultation paper is more definitive (indicating that the additional capital requirement *will not* be applied), it would be best if this commitment were reflected in the enduring prudential framework not just in the consultation paper.

Both these measures reflect that both the benefits and burdens of IRB accreditation should broadly match the extent to which that accreditation has been phased in. We note that the additional capital charge for interest rate risk in the banking book (IRRBB) under APS 117 appears to apply in full from the date of first IRB accreditation. We recommend that APRA consider whether the immediate application of the IRRBB capital charge upon initial accreditation, when full accreditation of the ADI's material business is not yet complete, is consistent with its broader approach to phasing in costs and benefits progressively. Clarity on when the charge is applicable will improve an ADI's capacity to assess potential costs and benefits when making a decision to seek and achieve accreditation, and its capacity to manage its capital stack during the accreditation process.

## Operational risk

APRA appropriately expects that an ADI seeking accreditation will demonstrate an advanced approach to managing all material risks. In draft paragraph 156 of APG 113, APRA indicates that this approach should incorporate 'techniques to obtain a quantitative understanding of all material risks'. This expectation presumably includes operational risks, covered by CPS 230, but there is no further detail in the proposed changes to APG 113 on what reasonable quantitative estimates of risk would look like to support APRA's advanced management expectations.

Expectations of ADIs can vary considerably under CPS 230 depending on the features of each ADI. In obtaining IRB accreditation an ADI would presumably be taking on the expectation of conducting more advanced, quantitative estimates of operational risk. But the exact level of that expectation, especially for a newly-IRB-accredited ADI, has the potential to be subjective without some clear criteria for APRA and ADIs to refer to. APRA could provide more guidance on what reasonable quantitative estimates of risk – especially operational risk – should be, to ensure consistent and objective assessment of risk management capabilities.

## Observations on the timeline

### Nature of APRA feedback during initial engagement stage

The ABA welcomes APRA's proposed timeline for an end-to-end IRB accreditation process, including a period of initial engagement where an ADI and APRA can discuss APRA's expectations and ensure the ADI has sufficient information to support a decision to begin accreditation. These early discussions will be essential to avoiding wasted or misdirected investment. While the exact nature of these discussions will depend on the circumstances of each ADI, as a general rule the discussions will be most useful if APRA is willing to provide concrete guidance – potentially including early non-binding review of models (for those ADIs that seek it) – rather than only high-level discussions about an ADI's overall readiness.

### Status of models at development, pre-application and application stage

The pre-application review is another very welcome element of the proposed timeline, providing an opportunity for more detailed feedback on final models and other criteria. The validation and finalisation of models is a central element of IRB accreditation and the more guidance from APRA in the course of their development will be essential to the smooth implementation of the new pathway.

By the time an ADI enters the pre-application review stage it will likely have made significant investments into the development of its models. If APRA were to raise any significant concerns with these models at this stage, another round of external validation could be required, which would increase costs and delay timelines. The ABA encourages APRA to consider what guidance, even informal feedback, can be provided on major model components during the development phase to reduce the risk of set-backs at the pre-application stage.

APRA expects that the models submitted for the pre-application review are final, fully documented and validated (draft paragraph 173 of APG 113). It also expects that, during the application stage, an ADI has undertaken at least one cycle of annual validation and governance processes. If the models are not finalised until the end of the pre-application stage, unless the application stage is to extend beyond twelve months (well beyond the nine months in the indicative timeline), the annual validation and governance cycle will have to be completed with less than a year's implementation of final models. It would be helpful if APRA's materials expressly recognise that this first annual cycle need not take place a full twelve months after finalisation of the models.

### Length of the application (approval) stage

APRA's indicative timeline includes nine months for the 'application' stage, that is, the stage during which APRA is considering its decision on the ADI's final application. This is the longest stage in the indicative timeframe (noting that the development stage does not have an indicative number of months).

The ABA recognises the considerable work that must go into IRB accreditation decisions, to ensure the rigour of the process and to satisfy APRA that a sophisticated level of risk management has been achieved and will be sustained. APRA's new pathway allows this work to be undertaken via a range of pre-application engagement points with APRA, at multiple stages, with different levels of formality and directness of feedback. Given this approach, there may be an opportunity to shorten the indicative window for final APRA approval. For example, if APRA had already reviewed the validated models, and

there were no significant changes following the pre-application phase, there may be scope for APRA's final decision to be made in a shorter period.

The ABA recognises that the timeframes in draft APG 113 are merely indicative, and that actual approval times will vary based on a range of factors. We note that draft paragraph 178 of APG 113 states that APRA will endeavour to provide a decision within nine months, but notes circumstances where the decision may take longer. We would welcome a clear commitment from APRA to make its final decision on accreditation as soon as practicable, in the circumstances of each application, without unduly hurrying or compromising the rigour of the accreditation process.

### Sequencing of accreditation phases

The ABA welcomes APRA's increasing the expected timing for completing a phased roll-out of an IRB approach from two years to three years (draft paragraph 162(a) of APG 113). This is a sensible extension to allow an ADI room to plan its IRB roll-out, especially given the clarification that the process can begin with just a single portfolio.

We note that the indicative timeline in APG 113 extends beyond twelve months per phase, which suggests that an ADI will be able to develop its models for approval in parallel (or staggered but overlapping) rather than waiting for one accreditation outcome to be complete before commencing another. We would welcome more detail from APRA on how this will work in practice, perhaps providing a case study in APG 113.

We also note that this approach may have an impact on APRA's resources. We encourage APRA to ensure it maintains sufficient capacity to enable it to consider multiple simultaneous ADI applications dealing with multiple portfolios at different stages of the accreditation process. This capacity would likely need to be in addition to the resources currently devoted to IRB matters, as the ability to support already-accredited IRB banks with timely model approvals and robust oversight of IRB governance is critical to maintaining a resilient banking system.