



Discussion Paper

Enhancements to the Basel II Framework in Australia: reporting requirements

5 May 2010

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Preamble

This discussion paper outlines proposed changes to APRA's prudential reporting requirements relating to the changes in prudential standards for authorised deposit-taking institutions (ADIs), which APRA released for consultation on 21 December 2009.

Subject to consultation, APRA envisages that the amendments to the prudential reporting requirements will be implemented from 1 January 2011, along with the proposed amendments to prudential standards. The first submission of quarterly data required from ADIs will relate to the reporting period ending 31 March 2011.

This discussion paper and the associated draft prudential standards are available on APRA's website at www.apra.gov.au. Written submissions on the paper should be forwarded by 1 June 2010 to:

Basel II
Policy, Research and Statistics
Australian Prudential Regulation Authority
GPO Box 9836
Sydney NSW 2001
or email: basel2enhancements@apra.gov.au

Important

Submissions will be treated as public unless clearly marked as confidential and the confidential information contained in the submission is identified.

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.

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Glossary

ADI	Authorised deposit-taking institution
APRA	Australian Prudential Regulation Authority
APS	APRA Prudential Standard
ARF	APRA Reporting Form
BCBS	Basel Committee on Banking Supervision
BCC	Business Cost Calculator
IRB	Internal Ratings-based
LVR	Loan-to-valuation ratio
PPG	Prudential Practice Guide
VaR	Value-at-risk

Chapter 1 – Introduction

In December 2009, APRA released a package of proposed changes to prudential standards and prudential practice guides (PPGs) for authorised deposit-taking institutions (ADIs) to reflect enhancements to the Basel II Framework adopted by the Basel Committee on Banking Supervision (BCBS) in July 2009 ('the Basel II enhancements')¹. The Basel II enhancements are part of a broader work program undertaken by the BCBS to strengthen regulatory capital, risk management and supervision requirements. The consultation period for this package closed on 28 February 2010.

In that package, APRA indicated that the Basel II enhancements will require changes to APRA's reporting standards and reporting forms for both ADIs and consolidated banking groups under the *Financial Sector (Collection of Data) Act 2001*. APRA also indicated that it would issue these revised draft reporting standards and forms in the first quarter of 2010 with a view to issuing final prudential standards, PPGs, reporting standards and reporting forms in mid 2010.

During the consultation period for the December 2009 package, APRA received a number of comments from industry on various aspects of the proposed changes. APRA is currently reviewing these comments and will address the issues raised in a separate Response to Submissions paper.

Where appropriate, APRA will have regard to these comments when finalising the prudential standards and PPGs. However, the substance and nature of the comments received do not have a significant impact on the changes that need to be made to APRA's reporting standards and reporting forms addressed in this Discussion Paper. Nevertheless, there is scope to fine-tune the draft forms and instructions if required

based on any consultation feedback before they are finalised. Accordingly, APRA is releasing its proposed reporting changes now, to maximise industry time to complete the necessary transition in reporting systems. APRA's response to submissions on its proposed amendments to prudential standards and PPGs will follow in a separate paper.

Proposed changes to ADI reporting standards and reporting forms will involve changes to:

- *Reporting Form ARF 110.0.1 Capital Adequacy (Level 1) (ARF 110.0.1) and ARF 110.0.2 Capital Adequacy (Level 2) (ARF 110.0.2);*
- *Reporting Form ARF 116.0 Market Risk (ARF 116.0);*
- *Reporting Form ARF 120.0 Standardised Approach – Securitisation (ARF 120.0);*
- *Reporting Forms ARF 120.1A, ARF 120.1B and ARF 120.1C Internal Ratings-based (IRB) Approach – Securitisation (ARF 120.1A, ARF 120.1B, ARF 120.1C); and*
- *Reporting Form ARF 120.2 Securitisation – Supplementary Items (ARF 120.2).*

The proposed changes reflect the revised requirements set out in the December 2009 discussion paper for the following prudential standards:

- *Prudential Standard APS 111 Capital Adequacy: Measurement of Capital (APS 111);*
- *Prudential Standard APS 116 Capital Adequacy: Market Risk (APS 116); and*
- *Prudential Standard APS 120 Securitisation (APS 120).*

Subject to consultation, APRA intends to issue final reporting standards and reporting forms in mid 2010. These will accompany the release of the associated final prudential standards and PPGs. The first submission of quarterly data required from ADIs will relate to the reporting period ending 31 March 2011.

¹ www.apra.gov.au/Policy/ADI-Consultation-Packages.cfm

Chapter 2 – Changes to measurement of capital

The December 2009 proposals incorporate a restatement of the key principles governing the acceptable use of fair values for capital and other prudential purposes in the trading and banking books. This included, following the BCBS approach, the extension of valuation provisions previously applied for market risk more generally to the use of fair values in the banking and trading books. As part of this process, deductions required to be made from Tier 1 capital were clarified to include any fair value gains and losses that do not meet the enhanced requirements for use of fair value that are now proposed to be included in APS 111.

In light of these developments, APRA is proposing to amend reporting Forms ARF 110.0.1 and 110.0.2 to identify those fair values associated with the banking book and, separately, the trading book that are deemed to be ineligible to be included in Tier 1 capital and therefore required to be deducted from Tier 1 capital.

Where changes in fair values are no longer eligible to be included in Tier 1 capital, the associated changes in values of assets should also be adjusted to exclude such changes in value in measuring reported total risk-weighted assets.

The requirement to deduct from Tier 1 capital unrealised gains and losses arising from changes in own creditworthiness continues. It applies with regard to changes in the creditworthiness of the ADI at Level 1 and all members of a Level 2 group. To clarify the impact on capital at Level 2 of changes in own creditworthiness, APRA is proposing to amend Reporting Form ARF 110.0.2 to separate amounts required to be deducted due to changes in an ADI's own creditworthiness from deductions flowing from changes in the creditworthiness of other members of a Level 2 group.

Further details of these amendments are outlined in Appendix A.

Chapter 3 – Changes to the market risk reporting framework

The Basel II enhancements propose revisions to the 1996 market risk framework. These include supplementing the current value-at-risk (VaR) based trading book framework with a stressed VaR requirement, modifying capital calculation rules for securitised and resecuritised exposures in the trading book and setting the standard method charge for equity specific risk at eight per cent regardless of whether or not the portfolio is liquid and well diversified. APRA has proposed new requirements for APS 116 to implement these requirements.

These proposals require amendments to the prudential reporting framework for market risk – specifically, ARF 116.0 and its accompanying instructions. APRA has therefore amended ARF 116.0 and its accompanying instructions to reflect these proposals. Further details of these amendments are outlined in Appendix B.

Under APS 116 (Attachment C), ADIs that have APRA's approval to use the internal model approach must complete a number of tables related to stress testing, where the ADI has exposure to the relevant underlying market. In light of the global financial crisis, during which credit spread risk was a significant contributor to profit and loss volatility, APRA is proposing to modify the suite of stress tests so that it now includes a series of stress scenarios related to credit spread risk and these changes are reflected in proposed changes to reporting under ARF 116.0.

Chapter 4 – Changes to the securitisation reporting framework

The December 2009 proposals incorporate several changes in the treatment of securitisations, including changes to risk-weights for resecuritisations, use of ratings subject to self-guarantee, operational requirements for credit analysis and changes to credit conversion factors for eligible facilities.

Some of these proposals require amendments to the reporting framework for securitisation and have been included in the revised reporting requirements. Specifically, this includes higher risk-weights for resecuritisations under both the IRB and standardised approaches and changes to credit conversion factors for eligible facilities where APRA proposes to apply a consistent credit conversion factor for all eligible facilities regardless of term.

In the December 2009 proposals, APRA also sought to clarify that cash collateral facilities that meet the current requirements for such facilities set out in APS 120 will attract a 100 per cent risk-weight. Further proposed modifications include the requirement that an ADI not ascribe any value in its capital adequacy calculations to any positive mark-to-market value for a basis swap.

APRA is therefore proposing to amend ARF 120.0, ARF 120.1A, ARF 120.1B, ARF 120.1C and ARF 120.2 and their accompanying instructions, to reflect the December 2009 proposals relating to securitisation. Details of these specific amendments are outlined in Appendix C.

Chapter 5 – Request for cost-benefit analysis information

To improve the quality of regulation, the Australian Government requires all proposals to undergo a preliminary assessment to establish whether it is likely that there will be business compliance costs. In order to perform a comprehensive cost-benefit analysis, APRA welcomes information from interested parties.

As part of the consultation process, APRA requests respondents to provide an assessment of the impact of the proposed changes and, specifically, the marginal compliance costs ADIs are likely to face. Given that APRA's proposed requirements may impose some compliance costs, respondents may also indicate whether there are any other regulations relating to ADI capital adequacy that should be improved or removed to reduce compliance costs. In doing so, please explain what they are and why they need to be improved or removed.

Respondents are requested to use the Business Cost Calculator (BCC) to estimate costs to ensure that the data supplied to APRA can be aggregated and used in an industry-wide assessment. APRA would appreciate being provided with the input to the BCC as well as the final result. The BCC can be accessed at www.finance.gov.au/obpr/bcc/index.html

Appendix A – Proposed substantive changes to ARF 110.0

Form/table/column	Description of change
ARF 110_0_1	
2.2	Insertion of new total of net adjustments for ineligible unrealised fair value gains (losses).
2.2.1	Insertion of new item representing deductions for ineligible unrealised fair value gains (losses) on the banking book.
2.2.2	Insertion of new item representing deductions for ineligible unrealised fair value gains (losses) on the trading book.
2.3	Insertion of new total for other required fair value adjustments.
2.3.1	Insertion of net unrealised fair value gains (losses) on effective cash flow hedges. (This item was previously reported as 2.2).
2.3.2	Insertion of net unrealised fair value gains (losses) arising from changes in the ADI's own creditworthiness. (This item was previously reported as 2.3).
ARF 110_0_2	
2.2	Insertion of new total of net adjustments for ineligible unrealised fair value gains (losses).
2.2.1	Insertion of new item representing deductions for ineligible unrealised fair value gains (losses) on the banking book.
2.2.2	Insertion of new item representing deductions for ineligible unrealised fair value gains (losses) on the trading book.
2.3	Insertion of new total for other required fair value adjustments.
2.3.1	Insertion of net unrealised fair value gains (losses) on effective cash flow hedges. (This item was previously reported as 2.2).
2.3.2	Insertion of net unrealised fair value gains (losses) arising from changes in the ADI's own creditworthiness. (This item was previously reported as 2.3).
2.3.3	Insertion of new item for net unrealised fair value gains (losses) from changes in another member of the Level 2 group's own creditworthiness. (This item was previously included in the amount reported in 2.3).

Appendix B – Proposed substantive changes to ARF 116.0

Form/table/column	Description of change
ARF 116_0_SU	
2.2	Insertion of new total for the stressed VaR capital charge in accordance with the Basel II enhancements.
2.3	Insertion of new total for incremental risk capital charge.
2.4	Insertion of new total for the comprehensive risk capital charge for the correlation trading portfolio in accordance with the Basel II enhancements.
ARF 116_0_1	
1.14	Insertion of new sub-total for specific risk capital charge (standard exposures).
2	New risk category for securitisation exposures in accordance with the Basel II enhancements.
3	New risk category for resecuritisation exposures in accordance with the Basel II enhancements.
4	New risk category for correlation trading portfolio exposures in accordance with the Basel II enhancements.
5	Insertion of new total capital charge for Table 1.
ARF 116_0_3	
(Former) Column 2	Positions attracting four per cent specific risk charge deleted in accordance with Basel II enhancements.
ARF 116_0_13	
Column 3	Insertion of stressed VaR to be calculated across all asset classes in accordance with the Basel II enhancements.
Column 4	Insertion of average daily total stressed VaR for 60 trading days in accordance with the Basel II enhancements.
Column 7 and 8	Insertion of a separate multiplication factor set for VaR and stressed VaR in accordance with the Basel II enhancements.
Column 10	Insertion of scaled average stressed VaR in accordance with the Basel II enhancements.
7	Insertion of new comprehensive risk charge for ADIs with APRA approval to adopt the comprehensive risk approach for its correlation trading portfolio in accordance with the Basel II enhancements.
ARF 116_0_23	
	Addition of a new table of stress tests of trading book valuations, where the scenarios relate to movements in credit spreads.

Appendix C – Proposed substantive changes to ARF 120.0, ARF 120.1A, ARF 120.1B, ARF 120.1C, ARF 120.2

Form/table/column	Description of change
ARF 120_0	
Section A	
1.2	Addition of new resecuritisation exposures table in accordance with the Basel II enhancements.
Section C	Addition of new section on credit risk capital requirements relating to cash collateral lodged for securitisation and resecuritisation exposures.
Section E	
5.1.3.1	Insertion of new sub-categories relating to securitisation exposures that do not meet due diligence requirements.
5.1.3.2	Insertion of new sub-categories relating to resecuritisation exposures that do not meet due diligence requirements.
Section F	
6.1	Insertion of new sub-categories of resecuritisation and cash collateral.
6.2	Insertion of new sub-category of resecuritisation exposures.
ARF 120_1A	
Section A	Revision to specify exposures as securitisation exposures.
Section B	Insertion of new section on resecuritisation exposures.
ARF 120_1B	
Section A	Amendment to reflect changes to eligible facilities, regarding application of uniform credit conversion factor regardless of the term of a facility.
Section C	
3.1.3.1	Insertion of new sub-categories relating to securitisation exposures that do not meet due diligence requirements.
3.1.3.2	Insertion of new sub-categories relating to resecuritisation exposures that do not meet due diligence requirements.
ARF 120_1C	
Section A	Modification to include both securitisation and resecuritisation exposures.

Form/table/column	Description of change
ARF 120_2	
Section A	Modification to include assets supporting secured funding arrangements; addition of new column 5, specifying value of assets in pool.
2.1	Revision to specify securitisation securities; insertion of new columns (4), (5), (6), (7) and (8) to demonstrate compliance with due diligence requirements.
2.2	Addition of new table of resecuritisation securities; insertion of new columns (4), (5), (6), (7) and (8) to demonstrate compliance with due diligence requirements.
3.1	Revision to specify facilities categorised as securitisation exposures.
3.2	Addition of new table facilities categorised as resecuritisation exposures.
Section D	Insertion of new sub-categories including income from basis swaps and other derivatives.
Section E	
Table 1	Modification to include secured funding arrangements; new column to include value of funding received.
Table 2	Modification to include secured funding arrangements; new column to include pool loan to valuation ratio (LVR).



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