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To: All authorised deposit-taking institutions

Response to submissions on *Basel III liquidity – the net stable funding ratio and the liquid assets requirement for foreign ADIs*

On 29 September 2016, APRA released for consultation a response paper *Basel III liquidity – the net stable funding ratio and the liquid assets requirement for foreign ADIs* (September response paper), draft revised *Prudential Standard APS 210 Liquidity* (APS 210) and draft revised *Prudential Practice Guide APG 210 Liquidity* (APG 210).

The response paper and associated material set out APRA's revised proposals on aspects of the proposed implementation of the Net Stable Funding Ratio (NSFR) for authorised deposit-taking institutions (ADIs) and the future operation of the liquid assets requirement for foreign ADIs. APRA's revised proposals reflected comments received in submissions to the March 2016 discussion paper on the NSFR and the liquid assets requirement for foreign ADIs.

Net stable funding ratio

APRA received five submissions in response to the NSFR proposals. APRA's responses to the key matters raised (most of which were also raised in the March consultation) are set out below.

(i) Basel standardised credit risk weights

Two submissions argued that APRA should adopt the risk weight set out in the Basel II standardised approach to credit risk, rather than those set out in *Prudential Standard APS 112 Capital Adequacy: Standardised Approach to Credit Risk* (APS 112), for the purpose of determining the required stable funding (RSF) factor for unencumbered residential mortgages with a residual maturity of one year or more.

The alignment of the RSF factor for mortgages with APS 112, in APRA's view, remains appropriate. The lower, concessional RSF factor is premised on loans being higher quality, liquefiable assets. This is best reflected in loans with a lower loan to valuation ratio and those that meet the criteria for standard eligible mortgages as detailed in APS 112.

As noted in the September response paper, inconsistencies in risk weights for mortgages across jurisdictions may reduce in the medium term following revisions to the Basel Committee's standardised approach to credit risk, expected to be finalised around the end of 2016. This may materially address the concerns raised in submissions regarding alignment of RSF factors for unencumbered residential mortgages with those of international peers. APRA will monitor finalisation and implementation of the updated Basel framework and alignment under the NSFR. Should the anticipated alignment not occur, APRA will review this position.

(ii) Member-directed superannuation deposits

Three submissions raised the issue of the treatment of member-directed superannuation deposits, and questioned APRA's decision to only allow such deposits to be given a higher available stable funding (ASF) factor subject to a superannuation trustee (or other intermediaries) not being able to remove the deposits from an ADI within a defined period of time. Submissions argued that the size of the Australian superannuation system, and the stable nature of investment allocations, is reason to apply a lower, retail-like ASF.

APRA considers that the principles underlying the treatment of deposits under the NSFR remain appropriate. A key factor in determining the treatment of a deposit under APS 210 is the nature of the depositor. When an individual self-selects where to place their funds, the deposit is classified as retail. When a superannuation fund is making the deposit, the deposit is classified as being from a financial institution. The underlying principle is the distinction between an institution that manages money on behalf of others, and an individual managing their own funds. Consequently, APRA has not changed its proposed approach on this issue.

Member-directed superannuation deposits may be considered retail for the purposes of the Liquidity Coverage Ratio (LCR) if the conditions in paragraph 34 of Attachment A of APS 210 are met. This recognises circumstances where it is the individual, rather than an intermediary, that has full control over the placement and withdrawal of the funds. If such a deposit is considered to be retail under the LCR, the deposit may be considered retail for NSFR purposes as well. The requirement in the NSFR that the intermediary cannot remove the deposit from an ADI within a defined period is to ensure that it is the individual depositor that has control over the funds in the context of the time period relevant for the NSFR.

APRA's approach recognises circumstances in which deposits from superannuation funds may be a stable source of funding, notably where such deposits are operational deposits or the trustee is not able to remove the deposits from the ADI. This approach is consistent with the key consideration of the treatment being determined by the nature of the depositor and strikes an appropriate balance that allows for certain member-directed superannuation deposits to be accorded a higher ASF factor than would otherwise be the case.

(iii) Term deposits

Two submissions questioned why the maturity of retail term deposits with withdrawal notice periods must be taken as being the earliest possible date at which the funds may be withdrawn. Submissions noted that many ADI deposits with a maturity of greater than one year must, under APRA's approach, be treated as deposits with a 31-day notice period.

APRA's approach is consistent with the internationally agreed standard and appropriately reflects the practical operation of term deposits being that a depositor is contractually able to withdraw their funds after 31 days. One submission noted that term deposits with maturities greater than one year represent a small portion of retail term deposits; and APRA notes the difference in ASF factor is modest, being 90 or 95 percent under APRA's approach as opposed to 100 percent (until the term deposit residual maturity is less than one year).

(iv) Family trusts

Two submissions noted that draft APS 210 is silent on the treatment of personal investment entities (PIE), such as family trusts, with the presumption that accounts held by such entities are to be treated as financial institutions. In order to provide clarity on the treatment of PIEs set up solely for individual or family-related personal investment purposes, APRA has included the following guidance in APG 210:

Similarly, a personal investment entity, such as a family trust, with a small number of related individuals can be considered as a retail depositor with associated deposits classified as less stable retail deposits. Such investment entities would be operated and controlled by individuals within the same family, solely for the personal benefit of those same family members, with the trustee and/or manager also being a beneficiary.

(v) Treatment of open reverse repos

Two submissions queried APRA's proposed treatment of open reverse repos (that is, a reverse repo without a maturity date) noting that APRA's approach would result in application of a 100 per cent RSF factor. Submissions argued that open reverse repos are typically managed on a daily basis and such positions can be unwound at short notice by either party. To address this issue, APRA has inserted a provision in APS 210, consistent with the Basel Committee on Banking Supervision's position set out in *Net Stable Funding Ratio: frequently asked questions*, July 2016, such that, for a non-maturity reverse repo, an RSF factor of 100 per cent applies unless an ADI is able to demonstrate to APRA's satisfaction that the reverse repo will actually mature within a different maturity period.

(vi) Treatment of call funding exercisable at a bank's discretion

One submission questioned the treatment of call funding instruments where the issuing bank has the right to exercise the call. APRA's treatment, as outlined in the March discussion paper, is that such instruments must be treated as maturing on the earliest date at which the bank may exercise the call. APRA's view is that it is prudent and appropriate to model funding consistent with the instrument being called at the first available call date to reflect investors' expectations.

(vii) Securitisation

One submission raised the issue that amortising matched securitisation cash flows in the final six months of a securitisation receive asymmetric RSF and ASF factors. APRA remains of the view that this ASF/RSF mismatch is limited in time and not sufficiently material to warrant deviating from the internationally agreed standard.

Liquid assets requirement for foreign ADIs

Two submissions were received on the liquid assets requirement for foreign ADIs. Both submissions indicated their support for APRA's proposed continued application of the 40 per cent LCR. In addition, questions were posed relating to the practical application of the head office committed funding facility and aspects of the local operational capacity assessment. The application of the head office funding facility will be addressed in the upcoming consultation on revised reporting requirements, while the local operational capacity matters will be addressed as a supervisory matter with affected ADIs.

Other matters

In addition to the matters raised in submissions, APRA has provided additional guidance in APG 210 on APRA's expectations with respect to retail run contingency plans and utilisation of the Committed Liquidity Facility (CLF) by ADIs. Other minor edits, for clarification, have been made to paragraphs 116 and 121.

In the case of retail run contingency plans, APRA's supervision has identified a number of instances of shortcomings in adequately addressing the existing requirement in APS 210. The additional guidance in APG 210 will assist ADIs in improving practices in this area.

APRA has released the final revised versions of APS 210 and APG 210 along with this letter. The revised APS 210 will have effect from 1 January 2018. APG 210 provides updated guidance and will replace the existing APG 210. These documents can be found on APRA's website at:

http://www.apra.gov.au/adi/PrudentialFramework/Pages/Basel-III-liquidity-net-stable-funding-ratio-liquid-assets-ADIs-Dec16.aspx

Finally, APRA will consult on changes to the liquidity reporting standard in early 2017.

Yours sincerely

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