APRA

Response to Submissions

Implementing Basel III liquidity reforms in Australia

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Australian Prudential Regulation Authority

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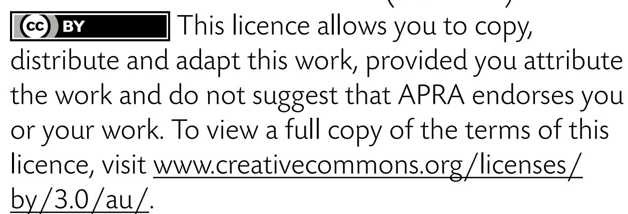
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Preamble

In December 2010, the Basel Committee on Banking Supervision (Basel Committee) released *Basel III: International framework for liquidity risk measurement, standards and monitoring*, which set out measures to strengthen liquidity buffers so as to promote a more resilient global banking system. In January 2013, the Basel Committee released a revised version of these measures in *Basel III: The Liquidity Coverage Ratio and liquidity risk monitoring tools*.

In response to the Basel Committee's releases, the Australian Prudential Regulation Authority (APRA) has previously issued three discussion papers:

- *Implementing Basel III liquidity reforms in Australia* (November 2011), outlining APRA's proposals to implement the Basel III liquidity framework in Australia. The consultation package included a draft *Prudential Standard APS 210 Liquidity* (APS 210);
- *Liquidity reporting requirements for authorised deposit-taking institutions* (November 2012), outlining the proposed statistical reporting framework for Basel III liquidity. The consultation package included a draft *Reporting Standard ARS 210 Liquidity* (ARS 210) and the suite of reporting forms and instructions that make up *Reporting Form ARF 210 Liquidity*; and
- *Implementing Basel III liquidity reforms in Australia* (May 2013), responding to the January 2013 revisions to the Basel III liquidity framework. The consultation package also included a response to submissions on APRA's November 2011 proposals that were not changed by the Basel Committee's revisions, as well as a revised draft APS 210 and draft *Prudential Practice Guide APG 210 Liquidity* (APG 210).

This paper provides a response to submissions on APRA's November 2012 reporting proposals and its May 2013 proposals on the liquidity prudential standard and prudential practice guide. Accompanying this paper are the final versions of APS 210 and APG 210, which will come into force on 1 January 2014. The suite of reporting forms that make up ARF 210 are currently being implemented using the Direct to APRA portal. These reporting forms, their associated instructions, and the final ARS 210 will be published on APRA's website, once the implementation process is completed in the near future.

This response paper and the final prudential and reporting standards and guidance are available on APRA's website at http://www.apra.gov.au/adi/PrudentialFramework/Pages/adi-consultation-packages.aspx.

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Glossary

ADI	Authorised deposit-taking institution
APG 210	*Prudential Practice Guide APG 210 Liquidity*
APRA	Australian Prudential Regulation Authority
APS 001	*Prudential Standard APS 001 Definitions*
APS 113	*Prudential Standard APS 113 Capital Adequacy: Internal Ratings–based Approach to Credit Risk*
APS 210	*Prudential Standard APS 210 Liquidity*
ARS 210	*Reporting Standard ARS 210 Liquidity*
Basel III liquidity framework	*Basel III: International framework for liquidity risk measurement, standards and monitoring*, Basel Committee on Banking Supervision, December 2010, as revised in *Basel III: The Liquidity Coverage Ratio and liquidity risk monitoring tools*, Basel Committee on Banking Supervision, January 2013.
Basel Committee	Basel Committee on Banking Supervision
CLF	Secured committed liquidity facility provided by the RBA
CLS	Continuous Linked Settlement
D2A	Direct to APRA. An electronic data submission system that enables regulated and registered financial entities to lodge their statutory returns with APRA.
ESA	Exchange settlement account
FOIA	*Freedom of Information Act 1982*
HQLA	High quality liquid assets
HQLA1	Equivalent to Level 1 HQLA in Basel III liquidity framework
HQLA2	Equivalent to Level 2A HQLA in Basel III liquidity framework
HQLA2B	Equivalent to Level 2B HQLA in Basel III liquidity framework
LCR	Liquidity Coverage Ratio
LCR ADI	An ADI subject to the Basel III quantitative liquidity requirements (previously termed 'scenario analysis ADI').
May 2013 discussion paper	*Implementing Basel III liquidity in Australia*, APRA, May 2013.
MLH	Minimum Liquidity Holdings
MLH ADI	An ADI exempt from the LCR requirement and subject to the MLH requirements
November 2011 discussion paper	*Implementing Basel III liquidity in Australia*, APRA, November 2011.
November 2012 discussion paper	*Liquidity reporting requirements for authorised deposit-taking institutions*, APRA, November 2012.
NSFR	Net Stable Funding Ratio
RBA	Reserve Bank of Australia
RMBS	Residential mortgage-backed security
Sound Principles	*Principles for Sound Liquidity Risk Management and Supervision*, Basel Committee on Banking Supervision, September 2008.

Executive summary

In December 2010, the Basel Committee on Banking Supervision (Basel Committee) released *Basel III: International framework for liquidity risk measurement, standards and monitoring*[1] (Basel III liquidity framework), outlining reforms intended to promote a more resilient global banking system.

The Basel III liquidity framework creates quantitative requirements in the form of two new global minimum standards:

- a 30-day Liquidity Coverage Ratio (LCR) to address an acute stress scenario; and
- a Net Stable Funding Ratio (NSFR) to encourage longer-term resilience.

Underpinning the Basel III liquidity framework are qualitative requirements for liquidity risk management, based on the Basel Committee's 2008 document, *Principles for Sound Liquidity Risk Management and Supervision* (Sound Principles).[2]

In January 2013, the Basel Committee released amendments to the LCR, set out in *Basel III: The Liquidity Coverage Ratio and liquidity risk monitoring tools.*[3]

APRA proposes to apply the quantitative liquidity requirements to the larger and more complex authorised deposit-taking institutions (ADIs). This includes most locally incorporated banks as well as a number of foreign bank branches. ADIs with simple, retailed-based business models will continue to be subject to a simple liquidity ratio requirement, the minimum liquidity holdings (MLH) regime. However, all ADIs will be subject to the qualitative requirements of the Basel III liquidity framework.

APRA's proposed approach to the implementation of the Basel III liquidity framework in Australia has been set out in three discussion papers:

- Implementing Basel III liquidity reforms in Australia (November 2011)[4](November 2011 discussion paper);
- Liquidity reporting requirements for authorised deposit-taking institutions (November 2012)[5] (November 2012 discussion paper); and
- Implementing Basel III liquidity reforms in Australia (May 2013)[6] (May 2013 discussion paper).

This paper provides a response to submissions on APRA's May 2013 proposals on updated draft *Prudential Standard APS 210 Liquidity* (APS 210) and draft *Prudential Practice Guide APG 210 Liquidity* (APG 210), in response to the Basel Committee's recent revisions. The paper also responds to submissions on APRA's November 2012 reporting proposals. However, the paper does not revisit issues raised on those of APRA's earlier proposals that have not been affected by the Basel Committee's recent revisions; these issues were addressed in the May 2013 discussion paper.

This completes APRA's consultations on one of the two new global minimum standards, the LCR. In its January 2013 release, the Basel Committee noted that the details of the NSFR, which does not come into effect until 1 January 2018, remain under review. APRA is fully committed to the implementation of the NSFR on the Basel Committee's timetable, but further consultation on this second of the new global minimum standards will await finalisation of the Basel Committee's rules text. Accordingly, the NSFR has been removed from the final prudential and reporting standards and is not considered further in this paper.

1 *Basel III: International Framework for Liquidity Risk Measurement, Standards and Monitoring, December 2010*, http://www.bis.org/publ/bcbs188.htm

2 *Principles for Sound Liquidity Risk Management and Supervision,* September 2008, http://www.bis.org/publ/bcbs144.htm

3 *Basel III: The Liquidity Coverage Ratio and Liquidity Risk Monitoring Tools*, January 2013, http://www.bis.org/publ/bcbs238.htm

4 Discussion paper, *Implementing Basel III liquidity reforms in Australia*, 16 November 2011, http://www.apra.gov.au/adi/PrudentialFramework/Pages/Implementing-Basel-III-Liquidity-Reforms-in-Australia-November2011.aspx

5 Discussion paper, *Liquidity reporting requirements for authorised deposit-taking institutions*, 9 November 2012, http://www.apra.gov.au/adi/PrudentialFramework/Pages/Liquidity-reporting-requirements-for-ADIs-November-2012.aspx

6 Discussion paper, *Implementing Basel III liquidity reforms in Australia*, May 2013, http://www.apra.gov.au/adi/PrudentialFramework/Pages/Implementing-Basel-III-liquidity-reforms-in-Australia-May-2013.aspx

Liquidity prudential standard and prudential practice guide

In its January 2013 release, the Basel Committee announced three amendments to the LCR, which involved:

- discretion for national authorities to include a wider range of liquid assets in the definition of high-quality liquid assets (HQLA);
- some refinements to the assumed cash inflow and outflow rates; and
- a revised timetable for phase-in of the LCR.

In its May 2013 discussion paper, in response to these revisions, APRA proposed not to exercise its discretion to include a wider range of liquid assets in the definition of HQLA, proposing instead to maintain its current definition of HQLA. APRA also proposed to adopt the revised Basel III cash inflow and outflow rates with only minor exceptions, and to introduce the LCR without phase-in arrangements, in line with the originally agreed global timetable. That is, all ADIs subject to the LCR would be required to meet a 100 per cent LCR on 1 January 2015.

Submissions were broadly supportive of APRA's proposed approach. Some submissions requested that APRA give further consideration to the list of Australian dollar debt securities eligible as HQLA, while other submissions requested that APRA reconsider the timetable for implementation. Further minor recommendations were also made.

APRA will not broaden its definition of HQLA in the domestic market. This definition was based on an assessment of the market characteristics of Australian dollar assets against the Basel III qualifying criteria that such assets must trade in large, deep and active markets, be liquid during a time of stress and, in most cases, be eligible for use in central bank operations. At this point, Australian dollar assets eligible for inclusion in a wider definition of HQLA do not meet these criteria. As stated previously, however, APRA will continue to review market developments in Australian dollar debt securities, and it is possible that the list of eligible HQLA may expand in future.

APRA will also adhere to its original timetable for the introduction of the LCR. As stated in the May 2013 discussion paper, the Basel Committee's phase-in arrangements were introduced in light of the considerable stress facing banking systems in some regions. Australia, however, is not one of those regions. Moreover, the majority of large internationally active banks are already compliant with the LCR.[7] Finally, APRA is cognisant of concerns, raised by the International Monetary Fund in its 2012 Financial System Stability Assessment of Australia[8], that the continued reliance of Australian banks on offshore funding leaves them exposed to disruptions to funding markets. Arguments raised in submissions that APRA should adopt the phase-in arrangements were not persuasive.

Accordingly, APRA has not made any material amendments to the drafts of APS 210 and APG 210 released in May 2013. APRA is implementing the Basel III rules text in full, with the exception of certain items where APRA has made use of the national discretion allowed or where APRA has departed from the rules text to reflect circumstances particular to Australia. Items under the first category include not expanding the definition of HQLA, and different treatment for the cash outflow rate for high run-off less stable retail deposits, contingent funding obligations and the method of calculating collateral flows related to the valuation of derivatives. Items under the second category include the treatment of self-managed superannuation funds, the recognition of head office liquidity support for Australian branches and foreign banks and the definition of liquid assets in New Zealand.

7 Results of the Basel III monitoring exercise as of 31 December 2012, released September 2013, http://www.bis.org/publ/bcbs262.htm

8 IMF – Financial System Stability Assessment – November 2012, http://apra.gov.au/AboutAPRA/Publications/Documents/cr12308[1].pdf

Liquidity reporting requirements

APRA's November 2012 discussion paper on reporting requirements introduced seven proposed reporting forms and an additional crisis reporting form. These forms covered reporting for the LCR, NSFR, balance sheet maturity, balance sheet forecast, minimum liquidity holdings and other relevant liquidity reports. The discussion paper also addressed the potential to determine that data submitted in each of these reporting forms is non-confidential[9], in order to facilitate publication of relevant material.

Broadly speaking, submissions were supportive of APRA's proposed reporting framework. A number of submissions requested further consideration of both the need for intraday reporting and the potential for a determination that data is non-confidential.

APRA has made a number of amendments to the reporting forms, in response to matters raised in submissions and to the January 2013 revisions to the LCR. These amendments include the removal of the day 1 to day 15 LCR from the LCR reporting form and the removal of the intraday reporting form. The NSFR reporting form has also been removed until the Basel Committee completes its review of the NSFR. APRA is also proposing to defer any consideration of the non-confidentiality of ADI liquidity data until it has consulted on ADI liquidity disclosure requirements in 2014.

APRA is currently implementing the suite of reporting forms that make up *Reporting Form ARF 210 Liquidity* (ARF 210) using the Direct to APRA portal and will publish these and *Reporting Standard ARF 210 Liquidity* (ARS 210) when they are finalised in the near future.

Reform of the securitisation framework

In coming months, APRA will commence consultations on proposed reforms to the prudential framework for securitisation. As part of these reforms, APRA will consider the appropriate treatment of securitisations for liquidity purposes. This may involve amendments to APS 210, which would be implemented at a later date.

A note on terminology

APRA has revised the term used to refer to ADIs that are subject to the quantitative requirements of the Basel III liquidity framework. These ADIs will now be termed 'LCR ADIs' rather than 'scenario analysis ADIs'. This is consistent with the terminology used in the Basel Committee's January 2013 release and acknowledges that from January 2014 onward, all ADIs, not just LCR ADIs, will be required to undertake scenario analysis in the form of the 'going concern' scenario.

9 Information that is protected by section 56 of the *Australian Prudential Regulation Authority Act 1998* is treated as confidential and is exempt from production under the *Freedom of Information Act 1982* (FOIA).

Chapter 1 – Introduction

In November 2011, APRA released a discussion paper, *Implementing Basel III liquidity reforms in Australia*, outlining its proposals to strengthen the liquidity risk management framework for ADIs in Australia. An accompanying draft APS 210 was also released for comment. The proposals gave effect to the reforms announced by the Basel Committee in December 2010, in its document *Basel III: International framework for liquidity risk measurement, standards and monitoring*, with the goal of promoting a more resilient global banking system.

The centrepiece of the Basel Committee's reforms is two new minimum global liquidity standards:

- an LCR requirement that aims to ensure that banking institutions have sufficient HQLA to survive an acute stress scenario lasting for one month; and
- an NSFR requirement that aims to promote longer-term resilience by requiring banking institutions to fund their activities with more stable sources of funding on an ongoing basis.

These two standards are intended to apply to internationally active banks. APRA proposed that, in Australia, the larger and more complex ADIs will be subject to these quantitative requirements.

In November 2012, APRA continued its consultations on the Basel III liquidity framework with the release of *Liquidity reporting requirements for authorised deposit-taking institutions*. In that discussion paper, APRA proposed the inclusion of seven new reporting forms and an additional crisis reporting form, allowing for the collection of key liquidity data to monitor compliance with the LCR and the NSFR, and to provide information on balance sheet maturity and the balance sheet forecast. Additional draft reporting forms were also included.

In January 2013, the Basel Committee announced amendments to the formulation of the LCR in its document *Basel III: The Liquidity Coverage Ratio and Liquidity Risk Monitoring Tools*. In response, APRA released a further discussion paper, *Implementing Basel III liquidity reforms in Australia*, in May 2013. In that discussion paper, APRA outlined its proposed changes to the implementation of the LCR in Australia, in response to the Basel Committee's amendments and to other issues raised in submissions on APRA's 2011 proposals that remained relevant. Accompanying the paper was an updated draft APS 210 and a draft APG 210.

This paper provides APRA's response to issues raised in submissions on its May 2013 proposals on APS 210 and APG 210 as well as its November 2012 proposals on liquidity reporting.

APRA notes that, in addition to the matters addressed in this response paper, a number of minor amendments have been made to APS 210, APG 210 and the associated reporting standard and reporting forms. These amendments improve the quality of these documents but are not of material impact.

Chapter 2 provides APRA's response on one issue related to the adoption of the Basel Committee's *Sound Principles*.

The following two chapters set out APRA's implementation of the LCR. Chapter 3 deals with the definition and identification of HQLA in Australia. Chapter 4 deals with cash inflows and outflows.

Chapter 5 addresses submissions on APRA's proposed liquidity reporting requirements.

Chapter 6 covers the implementation timetable.

The detailed rules text for the NSFR has yet to be finalised by the Basel Committee. Hence, this quantitative requirement, and associated reporting, is not covered in this response paper.

Chapter 2 – Qualitative requirements

In its November 2011 discussion paper, APRA proposed that the qualitative requirements of the existing APS 210 in respect of an ADI's liquidity risk management and oversight be expanded to incorporate the Basel Committee's *Sound Principles* and some additional APRA-specific requirements. This proposal was broadly supported by industry and other observers, and in many respects has already been adopted by ADIs.

APRA has not made any material amendments to the proposed qualitative requirements in the draft APS 210 provided with the November 2011 discussion paper. One issue regarding the qualitative requirements was raised in this consultation round.

The cost and benefits allocation process for funding and liquidity

Under draft APS 210, ADIs are required to develop and implement a costs and benefits allocation process for funding and liquidity that appropriately apportions the costs of prudent liquidity management to the sources of liquidity risk, and thus provides appropriate incentives to manage liquidity risk.

Comments received

Submissions reiterated a concern raised in earlier consultations that APRA's expectation that each ADI's process 'will be commensurate with the size and complexity of the ADI' was not captured in APS 210. Submissions proposed that APS 210 be amended to reflect this expectation.

APRA's response

The implementation of the cost and benefits allocation process is covered in APG 210. This states in its introduction that '[N]ot all the practices outlined in this PPG will be relevant for every ADI and some aspects may vary depending on the size, complexity and risk profile of the ADI'. APRA considers that this is a sufficient statement of its expectations with regard to size and complexity when considering the cost and benefits allocation process or any other part of the liquidity framework. No further amendment to APS 210 to APG 210 is therefore needed.

Chapter 3 – LCR – high-quality liquid assets

The determination of the LCR has two components:

- the value of the stock of HQLA in stressed conditions; and
- total net cash outflows, calculated according to a specified scenario.

This chapter deals with the first of these components.

Under the Basel III liquidity framework, assets qualifying as HQLA for LCR purposes must be unencumbered, easily and immediately convertible into cash with little or no loss of value under stressed market conditions and, ideally, be eligible for repurchase agreements with the central bank. In its original version, the Basel III liquidity framework included two categories of HQLA.

The highest quality liquid assets, which APRA refers to as HQLA1[10], can comprise an unlimited portion of the total stock of HQLA. These assets are limited to:

- notes and coin;
- central bank reserves (to the extent that these reserves can be drawn down in times of stress); and
- marketable securities representing claims on or claims guaranteed by sovereigns, quasi-sovereigns, central banks and multilateral development banks, that have undoubted liquidity, even during stressed market conditions, and that are assigned a zero risk-weight under the Basel II standardised approach to credit risk.

HQLA2 are assets with a proven record as a reliable source of liquidity even during stressed market conditions, and comprise:

- marketable securities representing claims on or by sovereigns, quasi-sovereigns, central banks and multilateral development banks, that are assigned a 20 per cent risk-weight under the Basel II standardised approach;
- corporate bonds (not issued by a financial institution or any of its affiliated entities) with a credit rating from a recognised external credit assessment institution of at least AA-; and
- covered bonds (not issued by the ADI itself or any of its affiliated entities) with a credit rating of at least AA-.

HQLA2 are limited to 40 per cent of the total stock of HQLA and attract a minimum 15 per cent haircut.

Following a review of a range of marketable instruments denominated in Australian dollars against the Basel III criteria for HQLA, APRA advised that:

- the only assets that qualify for HQLA1 in Australia are notes and coin, balances held with the RBA, and Commonwealth Government and semi-government securities; and
- there are no assets that qualify as HQLA2.

APRA also advised that it will keep this position under review, taking into account relevant market developments.[11]

In its January 2013 release, the Basel Committee introduced a third category of eligible assets, HQLA2B[12], which national authorities have discretion to include in LCR calculations. HQLA2B assets must trade in large, deep and active repo or cash markets and are limited to:

- residential mortgage-backed securities (RMBS) rated AA or higher, not issued by the bank itself or any of its affiliated entities;
- corporate debt securities rated between A+ and BBB-, not issued by a financial institution or any of its affiliated entities; and
- ordinary shares not issued by a financial institution or any of its affiliated entities.

In its May 2013 discussion paper, APRA proposed that it would not exercise its discretion to include HQLA2B in LCR calculations, and that its previously announced definition of HQLA in Australia would stand.

10 The Basel III liquidity framework refers to Level 1 and Level 2 HQLA. However, APRA uses the terms 'HQLA1' and 'HQLA2' to avoid any confusion with the terms 'Level 1' and 'Level 2', which have a different and well-established meaning in APRA's prudential framework.

11 See Media Release, APRA clarifies implementation of global liquidity standards in Australia, 28 February 2011, http://www.apra.gov.au/MediaReleases/Pages/11_03.aspx

12 The Basel III liquidity framework refers to Level 2B HQLA. However, consistent with the terminology APRA has adopted for HQLA1 and HQLA2, this paper will refer to HQLA2B.

In proposing this approach, APRA considered the range of possible Australian dollar debt securities against the qualifying criteria, taking into account the amount of these instruments on issue, the degree to which the instruments are broadly or narrowly held, and the degree to which the instruments are traded in large, deep and active markets. APRA gave particular attention to the liquidity of these instruments during the market disruptions of 2007–2009 in the more acute phases of the global financial crisis.

Based on that review, APRA concluded that there were no eligible HQLA2B debt securities in Australia.

APRA also reviewed the eligibility of unencumbered non-financial equities for potential inclusion as HQLA2B assets. Although the market for many listed equities in Australia is liquid, APRA does not consider that the inclusion of equities as HQLA2B assets would contribute to the resilience of the Australian banking system. Equities are not repo-eligible with the RBA and any large-scale forced sale of equity portfolios by one or more Australian banks could significantly exacerbate a stress event.

Submissions accepted this approach but raised some issues with regard to HQLA in LCR calculations.

HQLA for a consolidation banking group

In its May 2013 discussion paper, APRA stated that ADIs with material banking subsidiaries in other jurisdictions may be allowed to hold some amount of HQLA2B assets to meet the LCR requirements imposed by the host supervisor. However, until it was able to gain confidence in the liquidity of foreign currency HQLA2B assets in stressed circumstances, APRA did not believe that such assets should be recognised in LCR calculations for the consolidated (Level 2) banking group.

Comments received

A number of submissions raised concerns regarding APRA's restrictions on the inclusion of HQLA2B assets in LCR calculations, noting that their exclusion for the consolidated (Level 2) banking group would effectively make redundant the holding of HQLA2B assets to meet host supervisor requirements.

APRA's response

APRA retains a material concern about the liquidity of foreign currency HQLA2B assets to meet the consolidated (Level 2) banking group LCR requirement and, for this reason, sees it as appropriate to approach the inclusion of these assets cautiously. Until this concern is satisfied, ADIs will need to seek approval from APRA prior to any such assets being included in LCR calculations, as provided for in paragraph 27 of Attachment A of APS 210.

No change to the updated draft of APS 210 is required for HQLA2B assets.

Equitable CLF implementation

As a part of the implementation of the LCR in Australia, LCR ADIs will have access to a secured committed liquidity facility (CLF) with the Reserve Bank of Australia (RBA). The provision of the CLF will allow ADIs to meet the LCR requirement through the holding of both HQLA and other Australian dollar repo-eligible assets.

APRA will conduct an 'all reasonable steps' assessment of each ADI that requests a CLF for inclusion in the LCR. APRA released further details on the implementation of the CLF in its letter to industry of 8 August 2013.[13]

The all reasonable steps assessment seeks to ensure that each ADI requesting a CLF has in fact sought to manage its own liquidity to the extent possible through balance sheet management, before relying upon the CLF. Reasonable steps include reducing net cash outflows by increasing reliance on stable sources of funding, such as retail deposits and term wholesale funding, as well as holding HQLA1 in suitable quantity as part of a well-diversified portfolio of liquid assets.

13 *Implementation of the Basel III liquidity framework in Australia - Committed Liquidity Facility*, 8 August, 2013, http://www.apra.gov.au/adi/Publications/Documents/130808-CLF-letter-final.pdf

Comments received

Some ADIs were concerned that APRA may limit access to the CLF for some industry segments, requiring them to meet their Australian dollar LCR requirements wholly through their holdings of HQLA1. These submissions also sought clarity on APRA's expectations with regards to the all reasonable steps assessment.

Other submissions suggested that ADIs that already meet the LCR requirement using only HQLA1 should not be restricted in rebalancing their liquid assets portfolio by being denied access to a CLF. A general theme from these submissions was that each LCR ADI should be able to access an equitable share of the available CLF credit lines.

APRA's response

In its 8 August 2013 letter, APRA noted that any LCR ADI may request a CLF. APRA also made clear its method for setting the size of the CLF for an ADI, noting that it would be set in equal proportion to an ADI's target Australian dollar net cash outflows. This ensures that ADIs will be granted equal access to the CLF with respect to their absolute quantum of liquidity risk, as measured by the LCR.

APRA will consider it reasonable that ADIs currently holding significant HQLA1 liquidity buffers reduce the size of these buffers to a level in line with their peers, replacing HQLA1 assets with CLF eligible securities. In LCR calculations, assets that are eligible for inclusion as CLF eligible securities are, after the application of RBA margins, given equal standing to HQLA1.

As mentioned in its 8 August 2013 letter and paragraph 88(a) of APG 210, APRA expects that ADIs will hold HQLA1 at a level that recognises the available supply of those assets. The RBA has undertaken to supply, on an annual basis, an estimate of the aggregate amount of Australian dollar HQLA that could reasonably be held by LCR ADIs.

Chapter 4 – LCR – net cash outflows

The second component in the determination of the LCR, requires ADIs to calculate their net cash outflows over the next 30 calendar days under a stress scenario. The original Basel III liquidity framework provided many of the cashflow assumptions to be used for this purpose and APRA proposed to adopt these assumptions, except for minor modifications or clarifications.

The Basel III cashflow assumptions are based on the behaviour, during a stressed period, of the counterparties providing funding to the ADI and of those to which the ADI provides facilities (either credit, liquidity or contingency).

In its January 2013 revisions, the Basel Committee made a number of amendments to the calculation of net cash outflows. These included additional cash outflow categories, revisions to the cash outflow rates and some revised definitions.

APRA proposed to accept the revised Basel III assumed cash inflow and outflow rates, with only minor modification where appropriate to accommodate Australian market practice.

Intermediated deposits

In draft APS 210, APRA provided for a treatment for deposits sourced via an intermediary that was different to that for retail deposits. In its May 2013 discussion paper, APRA clarified the reasons for that different treatment, noting that where the intermediary retains investment responsibility or has a fiduciary duty to the underlying customer, APRA considers it appropriate to assume the intermediary will observe that responsibility and duty in a time of liquidity stress.

Comments received

Some submissions proposed that where the intermediary does not have authority to transfer the deposit without the depositor's consent, the deposit should be treated as retail. Submissions also proposed that where the fiduciary duty would likely result in a recommendation to withdraw the deposit, but not the actual withdrawal of the deposit, the deposit should be treated as retail.

One submission presented the example of a potential arrangement whereby the intermediary may have a contractual obligation to the receiving ADI to provide deposits with conditions in the contract that would restrict the ability of the intermediary to transfer the deposit to another ADI.

A further submission requested clarification of the phrase 'deposits sourced via an intermediary' in the May 2013 discussion paper. It was suggested that the use of this phrase may include, for example, deposits referred by financial planners and other non-financial institutions.

APRA's response

APRA considers that, in cases where a fiduciary duty exists, the intermediary will consider the complete withdrawal of intermediated deposits at a time of ADI liquidity stress. APRA does not believe it appropriate to consider alternative and weaker interpretations of fiduciary duty.

Where an intermediary enters into an arrangement with the receiving ADI to restrict its own ability to withdraw intermediated funds at a time of liquidity stress, while the intermediary can choose to do this with its own funds, such a contract would not limit its fiduciary duty toward its client. APRA also observes that such an arrangement appears dubious on its face for intermediaries with a fiduciary duty to others.

APRA clarifies that the phrase 'deposits sourced via an intermediary' used in the May 2013 discussion paper was less precise than the wording of draft APS 210. The definition of intermediated deposit in paragraph 34 of Attachment A of updated draft APS 210, viz 'where a natural person places funds with an intermediary, which then places those funds with an ADI', represents APRA's intent. APRA has determined that deposits from self-managed super funds are equivalent to retail deposits for the purposes of APS 210. Guidance on this is provided in paragraph 113 of APG 210.

Modelling of 31-day notice period deposits

In the May 2013 discussion paper, and updated draft APG 210, APRA detailed its expectations for modelling 31-day notice period deposits that are in a grace period (i.e. a period of a few days before the ADI can roll an existing deposit for a new term or notice period).

Comments received

A number of submissions noted that there is an inconsistency between draft APG 210 and the May 2013 discussion paper regarding the treatment of 31-day notice period deposits, where an ADI has received notice from the customer that the deposit is to be withdrawn.

APRA's response

APRA's intent is to allow ADIs to model 31-day notice period deposits that are in a grace period on an equivalent basis to a demand deposit, consistent with the requirements of paragraphs 40 - 41 in Attachment A of updated draft APS 210. Once an ADI has received notice that the 31-day notice period deposit will be withdrawn from the ADI upon its maturity, a 100 per cent run-off rate is to be applied. This is reflected in paragraph 115 of APG 210.

Definition of 'category' for retail fixed-term deposits

Updated draft APS 210 specified that if an ADI allows a depositor to withdraw a retail fixed-term deposit despite a clause that says the depositor has no legal right to withdraw, the entire category of these funds would be treated as demand deposits.

Comments received

One submission requested further clarification on the definition of 'category' for the purposes of treating the entire category of funds as demand deposits in the above circumstances. Specifically, clarification was sought as to whether multiple term deposit products with minor contractual differences offered by the same ADI would fall into differing categories.

APRA's response

The definition of 'category' aligns with the cash outflow categories as defined in Table 3 of Attachment A of updated draft APS 210, subject to jurisdiction and reporting consolidation considerations. Where an ADI allows a depositor to withdraw a retail fixed-term deposit outside of a hardship need, the entire category of deposits in that jurisdiction and reporting consolidation and within the same LCR category, not just those with similar contract structures, would be treated as demand deposits for LCR purposes.

Definition of financial institution

As noted in the May 2013 discussion paper, updated draft APS 210 cross-referenced the definition of 'financial institution' to *Prudential Standard APS 001 Definitions* (APS 001). APRA further clarified the definition in updated draft APS 210 to include money market corporations, finance companies, superannuation/pension funds, public unit trusts/mutual fund cash management trusts and friendly societies.

Comments received

One submission noted that the definition as worded in APS 001 may broaden the number of institutions classified as financial institutions in the liquidity standard, as it captures entities that provide ancillary services, not necessarily involving the independent management of money for clients or members.

APRA's response

APRA considers the definition of 'financial institutions' in APS 001 (and consequently in updated draft APS 210) to be appropriate from a liquidity risk perspective. APRA's approach to definitions is to seek consistency across the prudential framework, unless there are strong reasons for different definitions for different purposes.

Funding using central bank standing arrangements

Under repo transactions undertaken with a central bank, ADIs can post repo-eligible debt securities as collateral in order to secure cash for the term of the repo. The level and extent of such transactions differs by central bank.

Comments received

Submissions raised a concern about the interaction between the use of cash balances with the RBA as part of the CLF and the RBA's management of exchange settlement balances. ADIs will typically use interbank borrowing and lending as the primary means of settling balance differences on an overnight basis. In particular, submissions requested assurance that strategies involving the active management of exchange settlement balances to ensure HQLA1 compliance will not be adversely impacted.

APRA's response

Balances with the RBA that are available to cover cash outflows, including balances in exchange settlement accounts (ESAs), can be included in HQLA1 in LCR calculations. There are no restrictions in the LCR on the extent to which ADIs may use exchange settlement balances to manage liquidity.

Collateral postings due to market valuation moves

For the purposes of determining net cash outflows, an ADI must consider collateral outflows during the 30-day stress scenario as a result of adverse market valuation moves on positions for which the ADI may need to post collateral. As per Table 3 of Attachment A of updated draft APS 210, ADIs are required to take the largest absolute net 30-day collateral flow realised in the past 24 months and model this balance as an outflow. The revised Basel III rules text also states that 'supervisors may adjust the treatment flexibly according to circumstances'. As such, APRA also noted in the May 2013 discussion paper that it would consider an alternative outflow treatment that would acknowledge the direction of a currency movement in the stress event that is more consistent with historical experience.

Comments received

APRA received a number of responses on an alternative outflow treatment that would more closely correlate currency movements and collateral flows, as a means of identifying a more reasonable collateral outflow for LCR purposes.

APRA's response

APRA will give further consideration to the most appropriate treatment of currency-related collateral flows for LCR purposes. APRA will continue to consult on its purposed implementation with ADIs that would be most impacted.

Collateral treatment for branches whose collateral is centrally managed within the group

The revised Basel III framework details a number of requirements regarding derivatives, including the need to consider the potential for collateral outflows due to various triggers such as market valuation moves or ratings downgrades.

Comments received

Submissions requested additional guidance on how collateral items should be treated for branches of foreign banks in Australia where collateral management is not undertaken locally, and where master agreements may cover a number of ADI group entities.

APRA's response

Branches of foreign banks will be required to include all positions and balance sheet items in respect of the Australian branch in their liquidity reporting to APRA.

In addition, APRA will require that branches of foreign banks have a sound understanding of the liquidity risk implications of their collateral arrangements. Where all collateral is managed by other entities within the group, APRA expects that the Australian branch will make an assessment of whether, in a crisis event, there is any risk that collateral requirements could fall to the branch.

Committed facilities where drawdown is contingent on non-liquidity stress events

When determining net cash outflows for LCR purposes, the undrawn portion of committed credit and liquidity facilities is subject to various run-off rates depending on the specific characteristics of the committed facility.

Comments received

Submissions raised concerns about drawdowns on committed facilities where the drawdown is contingent on non-liquidity-related events. These committed facilities, including project finance and structured asset finance facilities, feature contractual conditions that have specific controls around drawdowns. These controls mean that the facility can often only be drawn following the occurrence of an event, such as the completion of construction work or some other project milestone. As a result, these 'event-dependent' facilities would not be expected to experience increased outflow activity in a bank-specific, or indeed market-wide, liquidity stress event.

Submissions noted that the Basel III framework addresses this issue by restricting the outflows to contractual loan drawdowns from committed facilities and estimated drawdowns from revocable facilities within the 30-day stress scenario timeframe.

APRA's response

APRA clarifies that event-dependent commitments, under which the undrawn portion can only be drawn subject to satisfying specific contractual conditions that fall beyond the 30-day stress scenario timeframe, are not subject to a run-off rate assumption.

Paragraph 22 of updated draft APG 210 has been amended to clarify that only the undrawn portion of committed facilities that can be contractually drawn within 30 days is to be included as outflows for LCR purposes.

Netting of foreign currency derivative transactions

Within the LCR, inflow and outflow categories relating to derivatives cover all foreign currency transactions, including spot transactions.

Some derivative transactions are subject to master netting agreements, which would allow for payment netting in the event of a counterparty default. Updated draft APS 210 allowed for derivative amounts payable and receivable to be taken into account on a net basis by counterparty where such a valid master netting agreement exists.

Comments received

A number of submissions enquired as to the treatment, for LCR purposes, of those foreign exchange transactions that are settled on a gross basis involving material flows from and to the ADI in two different currencies. ADIs raised the concern that, because these transactions would not be subject to a master netting agreement, the two legs would need to be included separately as a cash inflow and cash outflow. Where such foreign exchange transactions are a material part of the ADI's business, such a treatment would, it was claimed, result in the need to hold material levels of liquid assets as the ADI may be constrained by the 75 per cent cap on cash inflows in the LCR calculation.

These submissions requested that APRA also consider allowing for the netting of foreign exchange transactions across currencies.

APRA's response

The Basel III rules text makes clear that the netting of derivative transactions can only occur under a master netting agreement; there is no additional relief for foreign exchange derivatives.

Foreign exchange transactions need to be considered as a separate inflow and outflow. The settlement of these transactions will typically be in the form of an exchange of principal, and hence there is a need for an ADI to ensure that it has the principal balance ready for delivery.

APRA has given particular consideration to the settlement of foreign exchange transactions using Continuous Linked Settlement (CLS) via CLS Bank. Since September 2002, ADIs have been able to settle foreign exchange transactions using CLS Bank. CLS Bank provides a mechanism for settling foreign exchange transactions in 17 currencies, including the Australian dollar. These transactions are settled on a payment-versus-payment basis, thereby eliminating foreign exchange settlement risk. The CLS framework requires participants to meet settlement obligations by making payments into the ESA of CLS Bank on the date of settlement. While the transactions are settled on a gross basis, payment into the ESA of CLS Bank is made on the net of short currency exposures only. Under the current CLS framework, participants only confirm their obligations for CLS on the day that settlement is undertaken. As the LCR is a 30-day stress scenario, ADIs cannot reasonably estimate currency flows attributable to CLS settlements over the stress period. Hence, no specific relief for foreign exchange transactions settled through CLS Bank can be given.

However, APRA may give consideration to industry arrangements that allow for centralised clearing of currency derivative flows where these arrangements materially reduce the liquidity risk involved in foreign exchange transactions. This has been reflected in Table 3 of Attachment A of APS 210.

Head office funding (working capital deposits)

In order to fund the operation of a foreign bank branch, it is common practice for the head office to provide what is generally termed a working capital deposit. In the LCR calculations, such a deposit is to be modelled on the basis of the terms and conditions under which it is provided.

Comments received

Submissions sought clarification on the treatment of working capital deposits, asserting that these deposits represent the long-term investment of head office in the ongoing viability of the branch operation. Submissions argued that the liquidity value of such deposits in the liquidity framework should be equivalent to the value of capital to a locally incorporated ADI; this would result in the deposit receiving a zero per cent run-off rate in LCR calculations.

This issue also relates to retained earnings that appear on the branch's balance sheet until such time as they are repatriated to head office.

APRA's response

A deposit placed with a foreign bank branch by its head office on an overnight basis is appropriately treated as equivalent to an at-call deposit placed by a financial institution, and receives a 100 per cent run-off rate in LCR calculations. In a liquidity stress event, the head office retains the authority to repatriate those funds.

A foreign bank branch is able to put in place arrangements with its head office stipulating that head office funds will only be withdrawn subject to a notice period that is greater than 30 days. The branch can then recognise this notice period when modelling the deposit under APS 210. For such deposits, as the notice period is outside the 30-day stress scenario timeframe, the branch can assume that the deposit will remain with it in the stress event. A similar arrangement could also apply to retained earnings held by the branch.

Head office inflows

In the November 2011 discussion paper, APRA made provision for foreign bank branches to include a head office cash inflow in their LCR calculation. The funds were to be provided via a committed funding facility, could be of a size sufficient to cover net cash outflows from day 16 of the 30-day stress scenario timeframe, and the arrangements were to be subject to certain conditions, as outlined in draft APS 210.

Comments received

A number of submissions sought greater clarity on the treatment of the head office cash inflow – in particular, how the permitted level of support from head office was to be determined and whether the cash inflow would be subject to the 75 per cent cap on inflows.

APRA's response

The head office cash inflow can be sufficient in size to offset only net cash outflows that are due to occur between days 16 and 30 of the 30-day stress scenario timeframe.

In addition, the head office cash inflow is to be added to cash inflows in the LCR calculation and, as such, is subject to the 75 per cent cap on cash inflows. This requirement will ensure that foreign bank branches in Australia continue to maintain an appropriate level of local liquidity.

APRA has also modified the criteria for inclusion of the cash inflow in paragraph 58 of Attachment A of APS 210.

Operational deposit definitions

For LCR purposes, paragraph 47 of Attachment A of updated draft APS 210 provided a definition of operational deposits. Such deposits are those where customers place, or leave, deposits with an ADI in order to facilitate their access and ability to use payment and settlement systems and otherwise make payments. Paragraph 48 specifies that services must be provided to institutional customers under a legally binding agreement and the termination of such agreements must be subject either to a notice period of at least 30 days or significant switching costs to be borne by the customer if the operational deposits are moved before 30 days.

Comments received

A number of submissions provided feedback on the definition of operational deposits. Submissions were concerned that the definition was too narrow and would not allow the majority of deposits commonly considered by ADIs to be operational to be treated as such in LCR calculations. Submissions also argued that the requirement for a legally binding agreement would exclude almost all potential deposits in the Australian jurisdiction.

One submission argued that balances in excess of operational requirements in custodian deposits should be given a lower run-off rate than other financial institution deposits, given that evidence suggests that the volatility of the non-operational component of custodian accounts is very low.

Submissions also noted that the implementation of the LCR in other jurisdictions has allowed for correspondent banking deposits to be considered for treatment as operational deposits, where it can be demonstrated that specific account balances satisfy the relevant qualifying criteria. Submissions suggested that APRA should follow this approach.

APRA's response

APRA will maintain the current definition of operational deposits, which is consistent with the definition in the Basel III rules text.

For the purposes of the LCR, 'institutional customers' refers to all counterparties whose deposits may be qualifying operational deposits. However, standard business banking terms & conditions (and Product Disclosure Statements) will be sufficient to meet the requirements of a legally binding agreement.

APRA also notes that only the operational proportion of any deposit is subject to the lower run-off rates, and this is also the case for custodian deposits. Consistent with the Basel III rules text, deposit balances in excess of the operational component are to be included in relevant deposit categories as listed in the LCR.

Whatever amendments might be made in other jurisdictions, APRA does not consider that correspondent banking accounts should receive a treatment in Australia that is different to the Basel III framework.

Revocable facilities

In the Basel III framework, supervisors have the discretion to set cash outflow rates for revocable credit and liquidity facilities. These facilities are provided to customers under terms and agreements that would allow the ADI full discretion to withdraw the facility at any time. APRA proposed that revocable credit and liquidity facilities be subject to a five per cent run-off rate.

Comments received

Submissions raised concerns about the application of the five per cent cash outflow rate for undrawn revocable credit commitments for both retail and wholesale portfolios. In particular, submissions highlighted the extensive use of revocable facilities in overseas jurisdictions, noting that APRA's inclusion of an outflow rate for these facilities might differ from supervisors in other jurisdictions where a zero per cent run-off rate might be used.

APRA's response

APRA remains of the view that customer relationships, reputational considerations, business growth targets and the possibility of a delayed response to an emerging liquidity stress may mean that an ADI will not necessarily respond to liquidity stress by cancelling or withdrawing these types of facilities in the first instance.

As a result, APRA believes it is appropriate to include a small, non-zero run-off rate for revocable credit and liquidity facilities. No change to updated draft APS 210 has been made.

Trade finance

APRA proposed that ADIs include a cash outflow in LCR calculations for trade finance facilities based on the average of actual monthly outflows in the trade finance portfolio over a recent 12-month period. The Basel Committee's January 2013 release included guidance that the run-off rates modelled against trade finance facilities should be between zero and five per cent.

Comments received

Submissions sought clarification on the definition of trade finance facilities, while proposing that APRA make an explicit statement that the run-off rate for trade finance would not be greater than five per cent. Submissions also proposed that trade finance outflows be net of trade finance facility inflows as this would more usually reflect the actual experience of the portfolios.

APRA's response

APRA will not specify a run-off rate for trade finance facilities but rather will maintain the requirement that ADIs use a modelling methodology based on actual experience. As noted in the May 2013 discussion paper, APRA expects that such a methodology will result in a run-off rate consistent with the Basel Committee's guidance. APRA has provided further guidance on the definition of trade finance in paragraph 133 of APG 210.

APRA also considers it reasonable to include trade finance inflows in the estimation of a net trade finance outflow rate. Table 3 of Attachment A of updated draft APS 210 has been amended to allow for netting of trade finance facility flows.

Chapter 5 – Reporting requirements

In its November 2011 discussion paper, APRA proposed a series of new reporting forms to allow for the collection of LCR and NSFR data, as well as standardised reporting of balance sheet maturity and balance sheet forecast. Additional reporting forms were included to collect data on large liability counterparties and for intraday liquidity and crisis reporting.

APRA proposed to make only minor changes to the MLH regime. However, the current APS 210 requirement for a 'going concern' cashflow projection would be extended to MLH ADIs.

APRA is now implementing the reporting forms using the Direct to APRA (D2A) portal. APRA will release the final reporting forms when D2A implementation has been completed in the near future.

Since it released its November 2012 discussion paper on liquidity reporting, APRA has revised and simplified its proposals on the reporting framework. This is as a result of revisions made by the Basel Committee as well as submissions received. In summary, APRA has made the following changes to its reporting framework.

Reporting Form ARF 210.1 Liquidity Coverage Ratio

- The day 1 to day 15 section of this reporting form has been removed. Branches of foreign banks that include a head office cash inflow will report the cash inflow as a single line item in the day 1 to day 30 section of the form.
- Following feedback received, a number of changes have been made to the categories included in the LCR report to better align with the Basel Committee's LCR reporting categories.
- Relevant amendments have also been made to reflect the Basel Committee's January 2013 revisions to the LCR.

Reporting Form ARF 210.2 Net Stable Funding Ratio

- In its May 2013 discussion paper, APRA advised ADIs of its intention to defer its implementation of the NSFR report.
- This reporting form has been removed from the suite of reporting forms that make up ARF 210. It will be implemented under ARS 210 after the Basel Committee completes its current review of the NSFR, likely to be in 2014.

Reporting Form ARF 210.3 Balance Sheet Maturity

- With the consolidation of some LCR categories and deferral of the NSFR reporting form, the balance sheet maturity reporting form has been expanded to include additional categories. This will provide APRA with a more comprehensive view of the balance sheet. This is consistent with feedback from ADIs that this is the most straightforward reporting form and hence the best form on which to collect more detailed information.

Reporting Form ARF 210.4 Balance Sheet Forecast

- The categories in the balance sheet projection reporting form have been consolidated. This reporting form will provide a high-level snapshot of the forecast balance sheet.

Reporting Form ARF 210.5 Minimum Liquidity Holdings Ratio

- Some categories in the MLH reporting form have been split to allow for the inclusion of the new class of ADI, the mutual bank, and redundant off-balance-sheet items have been removed. In addition, the calculation of MLH liabilities now aligns with *Reporting Form ARF 210.3 Balance Sheet Maturity* rather than *Reporting Form ARF 323 Statement of Financial Position* (Licensed ADI).
- The reporting consolidation for locally incorporated MLH ADIs has been aligned to the rest of APRA's reporting framework; locally incorporated ADIs will now submit the form on both a Level 1 and Level 2 basis.
- With the exclusion of the NSFR from the suite of reporting forms, this reporting form will now be known as *Reporting Form ARF 210.2 Minimum Liquidity Holdings Ratio.*

Reporting Form ARF 210.6 Supplementary Information

- The purpose of this reporting form was to collect information on funding concentrations by counterparty. The form is very similar to the large liability exposures information already collected by APRA under Reporting Form ARF 221.0 Large Exposures, section D. For this reason, it has been removed from the proposed ARS 210 and ARF 210.
- APRA notes that LCR ADIs are not currently required to submit ARF 221.0 section D. APRA will amend the relevant reporting standard and reporting instructions such that, from 1 January 2015, all ADIs will be required to submit this reporting form on a quarterly basis.

Reporting Form ARF 210.7 Intra-day Liquidity

- The intra-day liquidity reporting form will not be implemented at this time so that APRA can consult further on this form.

Crisis report

- In the November 2012 discussion paper, APRA proposed to include crisis reporting as a requirement for all ADIs under ARS 210. This proposal was first communicated by APRA in 2009 and, as described at that time, ADIs will only need to submit the report when requested.
- APRA proposed that the crisis reporting form be maintained in a Microsoft Excel format and that further consultation on the form would be undertaken in 2013. APRA will now conduct this consultation in 2014.

The rest of this chapter addresses those issues raised in consultations that are not superseded by revisions to the reporting forms outlined above. APRA notes that a number of minor amendments have also been made to the reporting forms.

Timing for auditable reporting

In the November 2012 discussion paper, APRA proposed that the first report under the new reporting standard would be due in January 2014, for the period ending 31 December 2013.

Comments received

Submissions raised concern that the implementation timetable was ambitious, given the need for ADIs to develop systems infrastructure and finalise data definitions and extracts to a standard that would meet the audit requirements for reporting in 2014. Deferral of the implementation date was recommended to allow ADIs time to complete the necessary systems and data changes.

APRA's response

APRA has revised the first reporting date for submission via D2A to 30 June 2014. In recognition of the development work needed to meet the new reporting requirements, APRA will expect that returns submitted for quarters ending 30 June 2014 and 30 September 2014 will be completed on a 'best endeavours' basis. These returns will therefore not be subject to the standard audit requirements as outlined in paragraph 12 of ARS 210.

For periods ending on and after 31 December 2014, APRA expects that ADIs will have formalised all internal processes and procedures for liquidity reporting. All submitted data from that period onward will be subject to the standard audit requirements.

Additional liquidity reporting requirements for MLH ADIs

In the November 2012 discussion paper, APRA proposed a number of enhancements to the reporting requirements for MLH ADIs. Along with enhancements to the existing reporting form AFR 210.5 (ARF 210.2 in the proposed reporting framework), APRA proposed that MLH ADIs would also have to submit *Reporting Form ARF 210.3 Balance Sheet Maturity, Reporting Form ARF 210.4 Balance Sheet Forecast*, and the now withdrawn *Reporting Form ARF 210.6 Supplementary Information.*

Comments received

Some submissions from MLH ADIs suggested that the additional liquidity reporting requirements would add an unnecessary burden, given that these ADIs already provide standardised liquidity reporting via D2A. Submissions argued that the marginal benefit that APRA would gain by receiving this data did not outweigh the cost of its provision.

APRA's response

The new liquidity reporting requirements will provide APRA with relevant information on the balance sheet profile of MLH ADIs that is not currently collected on the standardised MLH reporting form.

The enhanced liquidity reporting framework has been introduced to ensure that APRA has sufficient information to assess industry compliance with the liquidity framework and to strengthen its understanding of the balance sheets of ADIs. APRA does not anticipate that the additional reporting requirements will be a material burden for MLH ADIs. A prudent ADI would be generating and monitoring this data as part of its existing liquidity risk management processes.

Global reporting consistency

The LCR is being implemented globally by national authorities that have committed to the Basel III liquidity framework. For banks that are internationally active, this will mean reporting LCR numbers to various national authorities on reporting forms that, in principle, are requesting the same information but may include idiosyncrasies due to differences in local implementation.

Comments received

Internationally active ADIs raised concerns about potential jurisdictional issues, noting that the methodologies and assumptions for the quantitative requirements have not been specified in other jurisdictions to the same level of detail as APRA's proposed LCR reporting form.

APRA's response

As has been noted above, APRA has made amendments to the LCR reporting form ARF 210.1 in order to better align it with the Basel Committee's revised rules text. APRA expects that this will provide greater international consistency for those ADIs which are required to report to multiple national authorities.

Reporting Form ARF 210.3 Balance Sheet Maturity – actual versus expected maturity

The balance sheet maturity report is being requested on a standardised basis from all ADIs. APRA has proposed that items be included based on their contractual maturity date (or next callable date for an item with embedded options).

Comments received

Submissions requested clarification as to what items are to be reported on an actual contractual maturity basis and those on an expected maturity basis.

APRA's response

APRA advised that, for the purposes of ARF 210.3, all balance sheet items are to be reported according to their contractual term to maturity at the reporting date. ADIs are not to apply any behavioural assumptions on the maturity profile of items reported in this form. Balance sheet items with embedded options are to be reported at their next call date. APRA has expanded the reporting instructions to clarify the reporting basis of this form.

Reporting Form ARF 210.4 Balance Sheet Forecast

In the November 2012 discussion paper, APRA proposed the introduction of a new *Reporting Form ARF 210.4 Balance Sheet Forecast* to facilitate the reporting of data required for balance sheet projections and analysis of funding tasks.

Comments received

Submissions queried the efficiency and cost-effectiveness of completing balance sheet forecasts for foreign ADIs and raised concerns about potential quality issues for ADIs in providing forecasts up to 15 months ahead.

Submissions also questioned the premise of the balance sheet forecast and whether it should be completed on a going-concern basis. Submissions also requested information on the level of senior management oversight that was required over the submitted balance sheet forecast.

APRA's response

APRA does not believe that completing ARF 210.4 will be a significant burden for foreign ADIs, given that APRA expects foreign ADIs will already be undertaking balance sheet forecast analysis to identify funding requirements and for business performance budgeting. More generally, APRA notes that expectations that ADIs can predict their balance sheet growth and composition have increased considerably since the global financial crisis began.

As detailed in ARF 210.4, a 15-month forecast will be required. Given that this will be a quarterly collection and that receipt of the data in D2A is approximately one month after the reporting date, the 15-month timeframe will generally provide APRA with a minimum 12-month perspective on the balance sheet projections of ADIs.

The forecast balance sheet needs to be consistent with the approved business and funding plan endorsed by the Board or senior management, in accordance with an ADI's governance framework.

Reporting Form ARF 210.5 Minimum Liquidity Holdings

As outlined in the May 2013 discussion paper, recent revisions to the LCR announced by the Basel Committee gave discretion for national authorities to include a third category of liquid assets (HQLA2B) in the definition of HQLA.

Comments received

Some submissions argued that APRA should exercise its discretion to expand the definition of HQLA and that a wider range of assets should also be included in an expanded definition of the MLH portfolio.

APRA's response

As outlined in the May 2013 discussion paper and confirmed in this response paper, APRA will not exercise its discretion to include HQLA2B assets in LCR calculations. Accordingly, APRA is not extending the list of eligible MLH assets to include HQLA2B assets.

Crisis reporting – intra-month data quality

APRA proposed that the crisis report discussed above would only need to be submitted when requested; however, APRA will require that the report can be provided at any time on a one-day time lag.

Comments received

Submissions noted that to meet an on-demand reporting request, ADIs will be required to make assumptions and incorporate best estimates when submitting data. Accordingly, data quality may be lower than for other reporting to APRA that is typically provided via D2A.

APRA's response

Given the nature of the crisis reporting requirements, APRA understands that ADIs will need to include assumptions and some estimates where required. However, APRA notes that a level of auditability[14], consistent with the requirements in Paragraph 13 of ARS 210, needs to be retained given that, in times of liquidity stress, ADIs and APRA will place heavy reliance on the reported net cashflow results.

14 Results of the Basel III monitoring exercise as of 31 December 2012, released September 2013, http://www.bis.org/publ/bcbs262.htm

Consideration of the non-confidentiality of ADIs liquidity data

In its November 2012 discussion paper, APRA proposed to determine that data submitted on each of the liquidity reporting forms is non-confidential. A number of submissions commented on this proposal.

In July 2013, the Basel Committee released a consultation paper on its disclosure requirements for banks that are subject to the Basel III liquidity framework.[15] Until these disclosure requirements are finalised, APRA will not consider whether to determine that ADI liquidity reporting data is non-confidential. Instead, it will address this issue as part of a broader consideration of disclosure requirements in 2014.

15 *Liquidity coverage ratio disclosure standards - consultative document,* July 2013, http://www.bis.org/publ/bcbs259.htm

Chapter 6 – Implementation of the LCR

In line with the original Basel Committee timetable, APRA proposed to introduce the LCR requirement from 1 January 2015 and the NSFR requirement from 1 January 2018. APRA did not propose to include any transitional arrangements for these requirements.

Transitional arrangement for LCR implementation

In its January 2013 release, the Basel Committee allowed for a phase-in of the LCR, with a minimum requirement of 60 per cent from the 2015 start-date, rising in equal annual steps of 10 percentage points to reach 100 per cent on 1 January 2019. The graduated approach was designed to ensure that the LCR can be introduced '...without disruption to the orderly strengthening of banking systems.'[16] APRA proposed not to adopt the phase-in arrangements.

Comments received

Submissions raised concerns regarding APRA's proposal to impose the LCR requirement in full on 1 January 2015. In particular, concern was expressed that requiring material subsidiaries of ADIs operating in other jurisdictions to meet APRA's 100 per cent LCR requirement while competitors in those jurisdictions may be subject to phase-in arrangements would cause significant competitive disadvantage. Some submissions suggested alternative phase-in arrangements.

APRA's response

APRA will not be adopting the phase-in arrangements. As noted in the May 2013 discussion paper, these arrangements were introduced in light of the considerable stress facing banking systems in some regions. Australia is not one of those regions, and APRA believes it is more prudent to adopt an implementation timetable that is fully consistent with the capability and needs of the Australian banking system. The Basel Committee has estimated that, on end-December 2012 data, the weighted average LCR for a sample of around 200 of the largest internationally active banks, on the revised calibration, was around 120 per cent. Some 68 per cent of the banks in that sample are already LCR compliant.

APRA expects that ADIs and their consolidated banking groups maintain robust liquidity positions at all times. For this reason, it is appropriate to apply the 100 per cent LCR requirement to the group, including material banking subsidiaries operating in other jurisdictions.

CLF for Australian dollar exposures only

In its November 2011 and March 2013 discussion papers, APRA proposed that ADIs be able to meet their liquidity needs in each material currency and maintain HQLA consistent with the distribution of their liquidity needs by currency. APRA also proposed that ADIs must specifically address currency mismatches in their Board-approved statement of liquidity risk tolerance.

Comments received

Submissions noted that ADIs are required to monitor the LCR for material currencies but that immaterial currencies will effectively be consolidated into the 'all currencies' LCR. This, it was argued, may cause problems where an ADI requires a CLF, as the CLF can only be used for Australian dollar outflows and would not be available to cover residual currency exposures.

APRA's response

APRA confirms that ADIs must hold HQLA in sufficient quantity to meet an 'all currencies' LCR of 100 per cent. An ADI's means of meeting this requirement will be determined in consultation with APRA, in the context of meeting liquidity needs in each material currency and maintaining HQLA consistent with the distribution of liquidity needs by currency. The CLF is available only to address a shortage of HQLA in Australian dollars; ADIs will have access to HQLA in other currencies to assist them in meeting their liquidity needs in those currencies.

16 Press release, *Group of Governors and Heads of Supervision Endorses Revised Liquidity Standard for Banks*, 6 January 2013 http://www.bis.org/press/p130106.htm

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