AFMA

12 September 2014

Mr Pat Brennan
General Manager, Policy Development
Policy, Statistics and International Division
Australian Prudential Regulation Authority
Level 26
400 George Street
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By email: policydevelopment@apra.gov.au

Dear Mr Brennan

Prudential Standard APS 210 - Liquidity for Foreign ADI Branches

The Australian Financial Markets Association (AFMA) welcomes the opportunity to comment on proposed amendments to Prudential Standard APS 210 Liquidity and reporting instructions in respect of foreign ADI branches.

Overall the proposals are viewed by our foreign ADI members as a positive and welcomed initiative, representing a more appropriate and effective liquidity framework for foreign branches. The proposed changes will have a material impact on the long term structuring of asset holdings and the very short notice for implementation presents a challenge and is disruptive to orderly management of business plans.

AFMA members are contributing specific technical comments to you on issues relevant to their particular businesses. The AFMA comments represent collective views which are of general application. The following points summarise our comments:

1. Proposal to delay timing of implementation
2. Proposal to broaden the definition of MLH securities.
3. Proposed 15 calendar day time horizon and the potential to continue with the 30 calendar day time horizon with the LCR requirement set at 50% until such time that APRA reassesses the nature and rationale underlying its application of liquid asset requirements to foreign branches in Australia.
4. Amended definition of expected derivative cash inflows and cash outflows that may be shown on a net basis.

1. Proposal to delay timing of implementation

AFMA's foreign ADI members view the modifications introduced in this consultation as material, requiring changes to internal methodologies which will for some banks result in incompatibilities with systems which are set up for standardised global operations that accord with home regulator requirements. The proposed changes will necessitate recalibration of calculation and reporting that will need to be validated within a very short period of time. Accordingly, fair and reasonable time is needed to consider these changes as a means of ensuring that they can be implemented in accordance with good governance and risk management protocols. An appropriate amount of time needs to be allowed to ensure all necessary governance approvals and new mandates for trading assets in the liquidity buffers can be obtained. Maintaining an implementation date of 1 January 2015 is not viewed as fair and reasonable by members.

If APRA took our advised course of delaying the implementation of LCR for foreign branches it would not be acting alone. It is especially relevant to Australian operations that Singapore has taken this approach. You are referred to the August 2014 announcement by the Monetary Authority of Singapore (See Page 6 Section 4 'Timeline for Implementation' of its 'Response to Feedback: Consultation on Local Implementation of Basel III Liquidity Rules – Liquidity Coverage Ratio. This announcement means that the 1 January 2015 implementation for LCR in Singapore is restricted to the large domestic banks only, with other institutions delayed until 2016.

A consequence of eliminating the CLF for foreign branches is that, unlike the scenario that exists with the CLF commitment, assets meeting the definition of MLH securities will no longer qualify as liquid assets at the Head Office level. Each foreign bank branch will need to choose between increasing the local compliance cost (by buying HQLA eligible securities) versus increasing the global HQLA requirement. When combined with the effects of losing recognition of home office support, our foreign branch members believe that the cost of liquidity within the banking system is likely to increase, and irrespective of whether this increase is borne in the home office or locally. As is the case with increased regulatory costs, this cost will ultimately be passed on to the real economy in Australia.

Given these concerns our foreign ADI members were of the opinion that APRA should give consideration to delaying the implementation as now proposed for foreign bank branches, and at least until 2016, and commensurately extend the current reporting regime applied to foreign branches.

In proposing the delay, the foreign ADI's note that the proposed change is an interim measure, and believe this will ensure APRA and the foreign branches can work together to achieve a sensible transition path to the intended new liquidity regime. The case for taking the course of action is particularly strengthened by APRA's indication that it intends in 2015 to reassess the nature of and rationale underlying its application of liquid asset requirements to foreign bank branches in Australia. This being the case, and recognising the subtle differences in regulatory approaches taken or being considered in different jurisdictions which may ultimately have some influence on local approach to final implementation, our foreign branch members believe there is more merit in extending the implementation timeline by one year or more as opposed to making this change at short notice.

2. Potential to broaden the definition of MLH securities

A consequence of the elimination of the CLF for foreign branches is that a foreign branch stands to lose its guaranteed liquidity in a stressed environment. Taking into account that CLF eligible securities included all classes eligible for repurchase with the RBA, our foreign ADI members believe that the full suite of RBA repo eligible assets should be now included within the definition MLH securities as applicable to foreign branches thereby providing a form of substantial equivalence when compared to domestic ADI's and to what the foreign branch previously were relying on. By definition therefore, this would also include ABS, RMBS and covered bonds, categorised under attachment C; 3(g) as "any other securities approved by APRA".

3. Proposed 15 calendar day time horizon and the potential to continue with the 30 calendar day time horizon with the LCR ratio set at 50% until such time that APRA reassesses the nature and rationale underlying its application of liquid asset requirements to foreign branches in Australia

Our members were divided on this aspect, noting that the short time frame for consideration of this change somewhat hinders the ability to fully gauge impacts, while recognising the favourable implications of making allowance for home office support. The application of a 30 calendar day time horizon (as is applicable to domestic ADI's) combined with an LCR ratio of 50% would serve as an alternative short term approach, and for some foreign branches this more comfortably fits in with corresponding regulatory requirements in other jurisdictions and would be less disruptive as an interim measure until such time that APRA finalises its reassessment. This methodology is operationally less onerous, being more closely aligned to the calendar day time horizon generally applicable for global LCR calculations, and so is more readily understood by home offices.

Should APRA not pursue member's primary recommendation to delay timing of the implementation, we would ask APRA to consider a flexible approach to the time horizon window. This would involve allowing foreign branches the option to adopt either a 15 or 30 calendar day time horizon as described above, depending on their approach to prudent global management of liquidity in accordance with home regulator requirements.

4. Amended definition of expected derivative cash inflows and cash outflows that may be shown on a net basis

Our foreign ADI members welcome the amendments as proposed. However, it is suggested that further clarification is needed to ensure that particular derivatives types are not unnecessarily excluded from the netting protocol. For example, foreign exchange swaps are effectively recognised at 100% inflow value, however as cross currency swaps are not included in derivatives netting, as the latter are subject to the 75% inflow cap. This is notwithstanding that each are both funding related instruments and critical to the management of funding operations for foreign branches engaged in or relying on foreign currency debt issuance. Foreign exchange swaps and cross currency swaps can be used to produce functionally equivalent outcomes and an equivalent liquidity treatment should apply to both. Accordingly our members request APRA to consider allowing cross currency swaps to be afforded the same treatment as foreign exchange swaps.

Thank you for considering our comments in relation to this consultation. In addition to the points raised above relating directly to this consultation, our foreign ADI members suggest that APRA's subsequent consideration or clarification of the matters set out in Attachment 1 to this submission be considered either concurrently or for incorporation within its proposed 2015 reassessment of the nature and rationale underlying the application of liquid asset requirements to foreign branches in Australia, or as part of any subsequent development of a strategic foreign branch liquidity solution.

Please contact me at mregan@afma.com.au or on (02) 9776 7992 if further clarification or elaboration is desired.

Yours sincerely

Murray Regan
Director – Markets and Rates

Attachment 1

I. Clarification with regard to recognition of cash flows attendant to foreign currency interest rate swaps

AFMA's foreign ADI members have expressed reservations about whether, as drafted, the standards afford the same treatment to cash flows attached to foreign currency interest rate swaps as afforded to foreign exchange swaps, and accordingly clarification is sought given that these derivatives are a critical element in risk management for foreign ADI's engaged in foreign currency debt issuance.

II. Potential for removal of currency-specific liquidity buffers

In the view of AFMA's foreign ADI members, the maintenance of currency specific liquidity buffers at the Australian domestic level does not take into account the fact that the local branches of international banks generally have access to foreign currency liquid assets and funding held centrally at a bank group level. While it is recognised that there would need to be robust arrangements in place assuring this access, members have noted that in other jurisdictions relief along these lines is being afforded to the local foreign bank branches: As an example the Monetary Authority of Singapore has indicated it will provide relief in this regard, monitoring an institution's ability to prudently their liquidity risks by currency on a supervisory basis, while retaining the right to impose currency-specific liquidity requirements on an institution-specific basis should it deem this appropriate.

III. Potential for the removal of 75% cap on related party cash inflows, and on cash inflows associated with bonds pending settlement

Our AFMA's foreign ADI members believe that related party cash inflows should be exempt from the 75% inflow cap in the LCR calculation, similar to the provisions relating to wholesale inflows from financial institutions as described in paragraph 61(a) of APS210, where the related party is a financial institution irrespective of jurisdiction. In addition the removal of the cap on inflows from related parties is consistent with other jurisdictions and means consistent interpretation across national boundaries.

Our members believe that cash inflow on bonds pending settlement should also be exempt from the 75% inflow cap in the LCR calculation, and that either netting be allowed or the associated repo included.

Members have also asked for confirmation that, in a circumstance where the CLF is no longer available to a foreign branch, then the 50% cap on related party cash inflows relative to outflows, as described in APRA's 30th January 2014 letter to ADI's, will no longer apply.

IV. Allowance of T+2 reporting for foreign ADI's

Members have noted that APRA is requesting T+1 ad hoc reporting commencing 1 April 2015. This creates problems within global reporting systems in that output may not be available from these systems before T+2, particularly in the case of branches of European and U.S. banks where data is processed in the end of day run in the home jurisdiction. Our foreign branch members recommend that APRA revisit this, and allow T+2 reporting.

V. Clarification of Home versus Host regulator

The application of differential rules/assumptions by regulators in different jurisdictions means that there could be potentially significant differences between the home and local branch regulator.

In the context of a branch, it is difficult if not impossible to distinguish distinct legal entities within an overarching global corporate structure. Therefore, an alternative would be for foreign bank branches to be assessed against home regulator benchmarks rather than those of the local branch regulator. This form of regulatory coordination is the type of beneficial global cooperation that industry is urging the G20 Finance Ministers to consider directing the Financial Stability Board to be active in pursuing as part of its agenda.

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