CUSTOMER OWNED BANKING ASSOCIATION

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12 September 2014

Mr Pat Brennan
General Manager, Policy Development
Policy, Statistics and International Division
Australian Prudential Regulation Authority

By email: PolicyDevelopment@apra.gov.au

Dear Mr Brennan

Proposed Liquidity Changes

Thank you for the opportunity to comment on APRA's letter to all ADIs of 1 September 2014 proposing amendments to the liquidity prudential standard and associated reporting instructions.

As you know, COBA is the industry association for Australia's customer-owned banking institutions, representing 82 credit unions, 11 mutual banks and 6 mutual building societies.

COBA notes that the changes proposed by APRA do not have a direct impact on Minimum Liquidity Holdings (MLH) ADIs, and are limited to Liquidity Coverage Ratio (LCR) ADIs, and foreign bank branches in particular.

In this regard, COBA has no specific comments to make on the proposed changes.

However, COBA would like reiterate broader points about the inequitable treatment of Residential Mortgage Backed Securities (RMBS) under the LCR and MLH regimes.

While LCR ADIs are unable to hold RMBS as High Quality Liquid Assets (HQLA), they are able to hold these assets as collateral for the Committed Liquidity Facility (CLF), and APRA expects that "ADIs with access to the CLF are likely to hold these assets as part of a well-diversified portfolio."[1]

COBA is concerned about this approach as it in effect allows LCR ADIs to hold RMBS as part of their regulatory liquidity portfolio, while preventing MLH ADIs from adopting a similar approach.

[1] APRA, *Discussion Paper – Implementing Basel III liquidity reforms in Australia,* May 2013, p. 13.

The treatment of RMBS for liquidity purposes was recently considered by the Financial System Inquiry (FSI) in their Interim Report, which noted that "at present, RMBS holdings are only eligible as collateral for the RBA's committed liquidity facility," and that treating RMBS as HQLA "would encourage major banks to purchase RMBS from smaller ADIs and non-bank lenders,"[2] given that this could be cheaper than holding CGS or paying to use the CLF.

COBA would support this change, whereby all ADIs were able to use RMBS as a part of their regulatory liquidity portfolio. Such an approach would ensure competitive neutrality in access to higher return securities for regulatory liquidity purposes.

Allowing RMBS to be eligible as HQLA would be consistent with the international approach taken by the Basel Committee on Banking Supervision (BCBS) in its 2013 announcement that HQLA would be broadened to include RMBS.

We note APRA's submission in response to the FSI indicating its reluctance to change its position. The submission says HQLA must have "… a proven record as a reliable source of liquidity even during stressed market conditions,"[3] and that when APRA assessed RMBS against this and other criteria it "concluded in 2013 that RMBS in Australia were not eligible as liquid assets for the purpose of the LCR."[4]

APRA's submission also expresses concern that "The recognition of such securities as liquid assets for the purpose of the LCR would be a concessionary treatment and, therefore, a deviation from the Basel framework…"[5]

COBA notes that RMBS are repo eligible securities with the RBA, and therefore provide a "reliable source of liquidity," even during stressed market conditions. We also note that treating RMBS as HQLA would lead to greater international alignment of Australia's liquidity standards with other jurisdictions. For example, RMBS are currently HQLA eligible under the European Central Bank (ECB) draft

If APRA remains of the view that RMBS should not be treated as HQLA, then LCR ADIs will still have the benefit of RMBS for regulatory liquidity purposes under the CLF, while MLH ADIs will not. COBA believes that MLH ADIs with self-securitisation arrangements with the RBA should be entitled to a comparable benefit. As COBA has previously noted in submissions to APRA, this could take the form of a discount to an MLH ADI's prescribed minimum (above the 9 per cent prudential floor).

In this respect, we welcome APRA's acknowledgement that "an MLH ADI that has a self-securitisation arrangement in place will have strengthened its liquidity risk management framework and contingent liquidity buffer for crisis management purposes."[6] However, COBA remains of the view that APRA should go beyond simply noting these liquidity benefits and provide an actual tangible "discount" to MLH ADIs with self-securitisation.

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[2] FSI, *Interim Report*, July 2014, p. 2-15
[3] APRA, *FSI – Response to the Interim Report,* August 2014, p. 13.
[4] ibid.
[5] ibid., p. 14.
[6] APRA, *Discussion Paper – Implementing Basel III liquidity reforms in Australia,* May 2013, p. 8.

Such an approach would improve the competitive neutrality of the MLH arrangements relative to the LCR arrangements, without compromising financial safety or stability.

Please contact me on 02 8035 8448 or Micah Green on 02 8035 8447 to discuss this submission.

Yours sincerely

LUKE LAWLER
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