

01 March 2019

Ms Heidi Richards  
General Manager, Policy Development  
Policy and Advice Division  
Australian Prudential Regulation Authority  
Email: [ADIpolicy@apra.gov.au](mailto:ADIpolicy@apra.gov.au)

Dear Ms Richards

## APRA Response Paper: Leverage ratio requirement for ADIs

The Australian Banking Association (**ABA**) appreciates the opportunity to provide comments on APRA's Response Paper: Leverage ratio requirement for ADIs (**paper**) and the associated draft prudential standard APS 110 Capital Adequacy (**APS 110**) and draft Reporting Standard ARS 110.1 Leverage Ratio (**ARS 110.1**).

With the active participation of its members, the ABA provides analysis, advice and advocacy for the banking industry and contributes to the development of public policy on banking and other financial services. The ABA works with government, regulators and other stakeholders to improve public awareness and understanding of the industry's contribution to the economy and to ensure Australia's banking customers continue to benefit from a stable, competitive and accessible banking industry.

The ABA welcomes the revisions that have been made since APRA's initial February 2018 consultation paper. These include:

- Aligning the Australian implementation date (2022) with international implementation requirements.
- Setting the minimum leverage ratio requirement to 3.5 per cent for Internal Ratings-based (IRB) ADI.
- Allowing standardised ADIs to calculate their derivative and SFT exposures in accordance with Australian Accounting Standards.

However, the ABA does have three key concerns with the APRA proposals, which are:

1. The calculation the leverage ratio on a daily basis for quarterly reporting; and
2. The timing and implementation of modified SA-CCR.
3. The misalignment of capital reporting dates.

These concerns are discussed below.

### 1. Calculating the leverage ratio on a daily basis

The ABA is concerned that calculating the leverage ratio on a daily basis imposes an unnecessary regulatory burden on IRB ADIs. The ABA understands that APRA wants to minimise the risk of regulatory arbitrage (also referred to as "window dressing").

At present, IRB ADIs are unable to make these calculations on a daily basis would require significant investment on the part of IRB ADIS to develop systems. The high cost is driven by its complexity as it would need to address a number of data issues such as:

- Daily management accounting versus statutory accounting information
- Off-balance sheet items

- Consolidation or other entries performed on a monthly basis; and
- Regulatory adjustments – for example for derivatives, adjustments to netting and collateral would be needed on a daily basis.

The ABA questions the proportionality of this high regulatory cost impost given the relatively low risk of regulatory arbitrage occurring in the Australian jurisdiction. In particular, the high cost of what is supposed to be a “back stop” prudential measure. There is low or no incentive for ADIs to engage in “window dressing” because:

- IRB ADIs are already well in excess of the proposed minimum limit of 3.5 per cent.<sup>1</sup>
- IRB ADIs have low exposure to derivatives, money market or repo transactions (securities financing transaction or SFT) which could be used to “window dress” the quarter end ratio reported. These transactions were identified by the BCBS as a means by which a bank could manage leverage ratio reporting or “window dressing”.<sup>2</sup>
  - For example, derivatives and SFTs only make up around six per cent of IRB ADI’s total exposure measure. This is relatively small compare to a number of large international banks where these items are around 20 per cent of their total exposure measure (see ABA’s first submission on leverage ratios).
- The IRB ADIs liquidity coverage ratio (LCR) provides a countervailing incentive against using short term assets such as high quality liquid assets (HQLA) to “window dress” the reported leverage ratio. Reducing holding of HQLA negatively affects the group LCR and is a more a binding constraint for risk management than the leverage ratio.

Given the additional costs associated with the calculating the leverage ratio on a daily basis, there would need to be a demonstrated increased prudential risk which a more frequent calculation is intended to mitigate to ensure the benefits outweigh the costs of this proposal.<sup>3</sup> However, this additional risk of regulatory arbitrage presented by IRB ADI’s, has not been identified or quantified by APRA. Indeed, as noted earlier in the APRA paper, the evidence suggested that Australian ADIs are less incentivised to undertake regulatory arbitrage which this measure is trying to prevent. Therefore, it is unclear how a daily calculation is a necessary and proportional policy setting than the quarter end ratio recommended by BCBS. As noted by the FSI final report, policy makers should seek to reduce unnecessary regulatory burdens.

The ABA recommends that given the low risk of window dressing occurring, it would be more effective and proportional for the reporting of quarter end leverage ratios be monitored as part of APRA’s regular supervisory activities. If a particular IRB ADI demonstrates heightened volatility in various segments of money markets and derivatives around key reference dates (as referred to by BCBS), then more frequent calculation using either a daily or month end values should be considered by APRA in a future amendment to the prudential standard.

## 2. Timing and implementation of modified SA-CCR

The ABA is also concerned about the running of two exposure calculations in parallel. From 1 July 2019, for risk-based calculations, ADIs will commence measuring EAD for counterparty credit risk (CCR) using the standardised approach (SA-CCR). However, for leverage exposure, ADIs are expected to continue to apply the Current Exposure Method (CEM), until implementation of the revised leverage standards in January 2022 when the modified SA-CCR calculation is applied.

There are a number of challenges with running two exposure calculations in parallel namely operational complexities, risks and unnecessary overheads. The ABA recommends that APRA allow individual IRB ADIs to early adopt the modified SA-CCR calculation, should they wish to, for the leverage exposure calculation from 1 July 2019.

<sup>1</sup> [https://www.apra.gov.au/sites/default/files/Leverage%2520ratio%2520requirement%2520for%2520ADIs\\_0.pdf](https://www.apra.gov.au/sites/default/files/Leverage%2520ratio%2520requirement%2520for%2520ADIs_0.pdf)

<sup>2</sup> Basel Committee, *Newsletter 20*, October 2018, [https://www.bis.org/publ/bcbs\\_nl20.htm](https://www.bis.org/publ/bcbs_nl20.htm)

<sup>3</sup> Financial System Inquiry, *Final Report* (November 2014) Box 2: General principles for policy makers., page 12. [http://fsi.gov.au/files/2014/12/FSI\\_Final\\_Report\\_Consolidated20141210.pdf](http://fsi.gov.au/files/2014/12/FSI_Final_Report_Consolidated20141210.pdf).



### 3. Misalignment of reporting dates

ABA also has concerns about the proposed reporting date of the 28th calendar date for the leverage ratio as it is misaligned with exiting capital reporting timelines. The 28<sup>th</sup> is not practical as the leverage ratio relies upon inputs from the capital reporting timelines (business day 30). The ABA provided similar feedback during the ARF 222 and ARF 221 consultation process given the interrelationship between the capital reporting returns.

Accordingly, the ABA recommends that timing of reporting for the leverage ratio should remain business day 30, aligned with the timing of interrelated capital reporting returns.

If you have any questions or would like to discuss this submission, please contact [REDACTED] by phone on [REDACTED]

Yours faithfully [REDACTED]

[REDACTED]  
Policy Director