



## Prudential Standard APS 110

### Capital Adequacy

#### **Objectives and key requirements of this Prudential Standard**

This Prudential Standard requires an authorised deposit-taking institution (ADI) to maintain adequate capital, on both a Level 1 and Level 2 basis, to act as a buffer against the risk associated with its activities.

The ultimate responsibility for the prudent management of capital of an ADI rests with its Board of directors. The Board must ensure the ADI maintains an appropriate level and quality of capital commensurate with the type, amount and concentration of risks to which the ADI is exposed.

The key requirements of this Prudential Standard are that an ADI and any Level 2 group must:

- have an Internal Capital Adequacy Assessment Process;
- maintain required levels of regulatory capital;
- operate a capital conservation buffer and, if required, a countercyclical capital buffer;
- inform APRA of any adverse change in actual or anticipated capital adequacy; and
- seek APRA's approval for any planned capital reductions.

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## Authority

1. This Prudential Standard is made under section 11AF of the *Banking Act 1959* (~~the Banking Act~~).

## Application

~~2.~~ This Prudential Standard applies to all authorised deposit-taking institutions (ADIs) with the exception of: under the Banking Act, subject to paragraph 3.

~~3.2.~~ This Prudential Standard does not apply to:

- (a) a **foreign ADI**, which must, however, be subject to comparable capital adequacy standards in its home country; or
- (b) a **purchased payment facility provider (PPF provider)**.

~~4.3.~~ A reference to an ADI in this Prudential Standard, unless otherwise indicated, is a reference to:

- (a) an ADI on a **Level 1** basis; and
- (b) a **group** of which an ADI is a member on a **Level 2** basis.

~~5.4.~~ If an ADI to which this Prudential Standard applies is:

- (a) the holding company for a group ~~of bodies corporate~~, the ADI must ensure that the requirements in this Prudential Standard are met on a Level 2 basis, where applicable; or
- (b) a **subsidiary** of an authorised **non-operating holding company (authorised NOHC)**, the authorised NOHC must ensure that the requirements in this Prudential Standard are met on a Level 2 basis, where applicable.

## Interpretation

~~6.5.~~ Terms that are defined in *Prudential Standard APS 001 Definitions* appear in bold the first time they are used in this Prudential Standard.

~~7.6.~~ Where this Prudential Standard provides for APRA to exercise a power or discretion, this power or discretion will be exercised in writing.

~~8.7.~~ In this Prudential Standard, unless the contrary intention appears, a reference to an Act, Regulations or Prudential Standard is a reference to the Act, Regulations or Prudential Standard as in force from time to time.

## Definitions

~~8.~~ The following definitions are used in this Prudential Standard:

- (a) IRB ADI – means an ADI which has been approved by APRA to use the Internal Ratings-based Approach to credit risk;

- (b) [simple ADI – means a standardised ADI which satisfies the eligibility criteria for inclusion within the simplified framework]; and
- (c) standardised ADI – means an ADI which has not been approved by APRA to use the Internal Ratings-based Approach to credit risk.

### Adjustments and exclusions

9. APRA may adjust or exclude a prudential requirement in this Prudential Standard in relation to one or more ADIs or authorised NOHCs.<sup>1</sup>

### Previous exercise of discretion

10. An ADI must contact APRA if it seeks to place reliance, for the purposes of complying with this Prudential Standard, on a previous exemption or other exercise of discretion by APRA under a previous version of this Prudential Standard.

### **Responsibility for capital management**

~~9.11.~~ Capital is the cornerstone of an ADI's financial strength. It supports an ADI's operations by providing a buffer to absorb unanticipated losses from its activities and, in the event of problems, enables the ADI to continue to operate in a sound and viable manner while the problems are addressed or resolved.

~~10.12.~~ Capital management must be an integral part of an ADI's risk management, by aligning its risk appetite and risk profile with its capacity to absorb losses.

~~11.13.~~ The Board of directors (**Board**)<sup>2</sup> of an ADI has a duty to **ensure** that the ADI maintains a level and quality of capital commensurate with the type, amount and concentration of risks to which the ADI is exposed from its activities. In doing so, the Board must have regard to any prospective changes in the ADI's risk profile and capital holdings.

~~12.14.~~ An ADI that is a member of a group may be exposed to risks, including reputational and contagion risk, through its association with other members of the group. Problems arising in other group members may compromise the financial and operational position of the ADI. The **Board**, in determining the capital adequacy of the ADI at Level 1, must have regard to:

- (a) risks posed to the ADI by other members of the group, including the impact on the ability of the ADI to raise funding and additional capital should the need arise;
- (b) obligations, both direct and indirect, arising from the ADI's association with group members that could give rise to a call on the capital of the ADI; and

<sup>1</sup> Refer to subsection 11AF(2) of the Banking Act.

<sup>2</sup> Unless otherwise indicated, a reference to the Board of an ADI in this Prudential Standard is also a reference, where relevant, to the Board of the entity that heads the Level 2 group.

- (c) the ability to freely transfer capital (including situations where the group is under financial or other forms of stress) from members of the group to recapitalise the ADI or other members of the group. This includes consideration of:
  - (i) the integration of business operations within the group;
  - (ii) the importance of members of the group to the group;
  - (iii) the impact of cross-border jurisdictional issues;
  - (iv) differences in legislative and regulatory requirements that may apply to group members; and
  - (v) the impact of taxation and other factors on the ability to realise investments in, or transfer surplus capital from, group members.

### Internal Capital Adequacy Assessment Process

~~13.15.~~ An ADI must have an **Internal Capital Adequacy Assessment Process (ICAAP)** that must:

- (a) be adequately documented, with the documentation made available to APRA on request; and
- (b) be approved by the Board initially, and when significant changes are made.

~~14.16.~~ An ADI's ICAAP must be appropriate to the ADI's size, business mix and complexity of its operations and group structure ~~(as applicable)~~.

~~15.17.~~ An ADI that is part of a group may rely on the ICAAP of the group provided that the Board of the ADI is satisfied that the group ICAAP meets the criteria in paragraph 18 of this Prudential Standard in respect of the ADI.

~~16.18.~~ The ICAAP must include at a minimum:

- (a) adequate policies, procedures, systems, controls and personnel to identify, measure, monitor and manage the risks arising from the ADI's activities on a continuous basis, and the capital held against such risks;
- (b) a strategy for ensuring adequate capital is maintained over time, including specific capital targets set out in the context of the ADI's risk profile, the Board's-ADI's risk appetite and **regulatory capital** requirements. This includes plans for how target levels of capital are to be met and the means available for sourcing additional capital where required;
- (c) actions and procedures for monitoring the ADI's compliance with its regulatory capital requirements and capital targets. This includes the setting of triggers to alert management to, and specified actions to avert and rectify, potential breaches of these requirements;

- (d) stress testing and scenario analysis relating to potential risk exposures and available capital resources;
- (e) processes for reporting on the ICAAP and its outcomes to the Board and senior management of the ADI, and for ensuring that the ICAAP is taken into account in making business decisions;
- (f) policies to address the capital impact of material risks not covered by explicit regulatory capital requirements; and
- (g) an ICAAP summary statement as defined in paragraph 19 [of this Prudential Standard](#).

[17.19.](#) The ICAAP summary statement is a high-level document that describes and summarises the capital assessment and management processes of the ADI. It must outline at a minimum the aspects of the ICAAP listed in paragraphs 18(a) to 18(f) [of this Prudential Standard](#). The ICAAP summary statement must also include:

- (a) a statement of the objectives of the ICAAP, the expected level of financial soundness associated with the capital targets and the time horizon over which the ICAAP applies;
- (b) a description of the key assumptions and methodologies utilised by the ADI in its ICAAP, including stress testing and scenario analysis;
- (c) triggers for reviewing the ICAAP in light of changes to business operations, regulatory, economic and financial market conditions, group structure ~~(as applicable)~~ and other factors affecting the ADI's risk profile and capital resources;
- (d) a summary of the ADI's policy for reviewing its ICAAP, including who is responsible for the review, details of the frequency and scope of the review, and mechanisms for reporting on the review and its outcomes to the Board and senior management;
- (e) a description of the basis of measurement of capital used in the ICAAP, and an explanation of the differences where this basis differs from that used for regulatory capital; and
- (f) references to supporting documentation and analysis as relevant.

[18.20.](#) An ADI must ensure that its ICAAP is subject to regular and robust review by appropriately qualified persons who are operationally independent of the conduct of capital management. The frequency and scope of the review must be appropriate to the ADI, having regard to its size, business mix, complexity of its operations and group structure ~~(as applicable)~~, and the nature and extent of any changes that have occurred or are likely to occur in its business profile or its risk appetite. A review must be conducted at least every three years. The review must be sufficient to reach a view on whether the ICAAP is adequate and effective.

[19.21.](#) An ADI must, on an annual basis, provide a report on the implementation of its ICAAP to APRA (ICAAP report). A copy of the ICAAP report must be

provided to APRA no later than three months from the date on which the report has been prepared.

20.22. The ICAAP report must include:

- (a) detailed information on current and three-year projected capital levels relative to minimum regulatory capital requirements and target levels;
- (b) detailed information on the actual outcomes of applying the ICAAP over the period, relative to the planned outcomes in the previous ICAAP report (including analysis of the ADI's actual capital position relative to minimum regulatory capital requirements and capital targets and actual- versus\_-planned capital management actions);
- (c) a description of material changes to the ICAAP since the previous ICAAP report;
- (d) detail and outcomes of stress testing and scenario analysis used in undertaking the ICAAP;
- (e) a breakdown of capital usage over the planning horizon, as relevant, by material:
  - (i) business activity;
  - (ii) group members;
  - (iii) geographic spread of exposures; and
  - (iv) risk types;
- (f) an assessment of anticipated changes in the ADI's risk profile or capital management processes over the planning horizon;
- (g) details of any review of the ICAAP since the previous ICAAP report, including any recommendations for change and how those recommendations have been, or are being, addressed; and
- (h) references to supporting documentation and analysis as relevant.

21.23. The ICAAP report submitted to APRA by the ADI must be accompanied by a declaration approved by the Board and signed by the **CEO** stating whether:

- (a) capital management has been undertaken by the ADI in accordance with the ICAAP over the period and, if not, a description of, and explanation for, deviations;
- (b) the ADI has assessed the capital targets contained in its ICAAP to be adequate given the size, business mix and complexity of its operations and, at Level 2, given the location of operations of group members and the complexity of the group structure; and

- (c) the information included in the ICAAP report is accurate in all material respects.

### Measurement of capital adequacy

~~22. APRA uses a tiered approach to the measurement of an ADI's capital adequacy. It assesses the ADI's financial strength at three levels in order to ensure that the ADI is adequately capitalised, both on an individual and a group basis. These levels are:~~

~~23. Level 1 either:~~

~~24. the ADI itself; or~~

~~25. the **extended licensed entity (ELE)** (refer to *Prudential Standard APS 222 Associations with Related Entities*);~~

~~26. Level 2 either:~~

~~27. if the ADI is not a subsidiary of an authorised NOHC and the ADI has subsidiaries in addition to those included in its ELE, the consolidation of the ADI and all its subsidiary entities other than **non-consolidated subsidiaries**; or~~

~~28. if the ADI is a subsidiary of an authorised NOHC, the consolidation of the immediate parent NOHC of the ADI and all the immediate parent NOHC's subsidiary entities (including any ADIs and their subsidiary entities) other than non-consolidated subsidiaries;~~

~~29. unless APRA otherwise determines a different Level 2 composition for a group of companies of which the ADI is a member; and~~

~~30. **Level 3** the **conglomerate group** at the widest level.<sup>3</sup>~~

### Minimum risk-based capital adequacy requirements

~~31.24.~~ APRA will determine **prudential capital requirements (PCRs)** for an ADI. The PCRs, expressed as a percentage of total risk-weighted assets, will be set by reference to **Common Equity Tier 1 Capital, Tier 1 Capital and Total Capital**. PCRs may be determined at Level 1, Level 2 or both.

~~32.25.~~ The minimum PCRs that an ADI must maintain at all times are:

- (a) a Common Equity Tier 1 Capital ratio of 4.5 per cent;
- (b) a Tier 1 Capital ratio of 6.0 per cent; and
- (c) a Total Capital ratio of 8.0 per cent.

APRA may determine higher PCRs for an ADI and may change an ADI's PCRs at any time.

<sup>3</sup> ~~Capital requirements at Level 3 are determined by APRA separately to this Prudential Standard.~~



~~33.26.~~ An ADI must maintain risk-based capital ratios above its PCR<sup>s</sup> at all times. Risk-based regulatory capital ratios are to be calculated in accordance with Attachment A [to this Prudential Standard](#).

### Capital conservation buffer

~~34.27.~~ An ADI must hold a capital conservation buffer above the PCR for Common Equity Tier 1 Capital.

~~35.28.~~ The capital conservation buffer is 2.5 per cent of the ADI's total risk-weighted assets, unless determined otherwise by APRA. The sum of the Common Equity Tier 1 PCR plus the capital conservation buffer determined by APRA will be no less than 7.0 per cent of the ADI's total risk-weighted assets.

~~36.29.~~ Any amount of Common Equity Tier 1 Capital required to meet an ADI's PCR<sup>s</sup> for Tier 1 Capital or Total Capital, above the amount required to meet the PCR for Common Equity Tier 1 Capital, is not eligible to be included in the capital conservation buffer.

~~37.30.~~ Capital distribution constraints will apply when an ADI's Common Equity Tier 1 Capital ratio falls within the capital buffer ranges outlined in Table 1 of Attachment B. Capital distribution constraints apply to distributions that affect Common Equity Tier 1 Capital. Items considered to be distributions for these purposes include:

- (a) dividends and share buybacks;<sup>4</sup>
- (b) discretionary payments on **Additional Tier 1 Capital** instruments;<sup>5</sup> and
- (c) discretionary bonus payments to staff.<sup>6</sup>

~~38.31.~~ An ADI may apply to APRA to make payments in excess of the constraints imposed by the capital conservation buffer regime. APRA will only grant approval where it is satisfied that an ADI has established measures to raise capital equal to or greater than the amount above the constraint that it wishes to distribute.

### Countercyclical capital buffer

~~39.32.~~ An ADI must hold additional Common Equity Tier 1 Capital as a countercyclical capital buffer, to be calculated in accordance with Attachment C [to this Prudential Standard](#) (ADI-specific countercyclical capital buffer).

<sup>4</sup> [This includes all distributions on mutual equity interests which must be treated as dividends for the purposes of this Prudential Standard, as required by Prudential Standard APS 111 Capital Adequacy: Measurement of Capital.](#)

<sup>5</sup> All payments of dividends or interest on eligible Additional Tier 1 capital instruments are, by definition, required to be discretionary.

<sup>6</sup> This would include any remuneration payments that are made upon the exercise of a discretionary judgment of the Board or senior management of an ADI as to the amount or timing of payment.

~~40.33.~~ APRA will determine the countercyclical capital buffer for the Australian jurisdiction (Australian jurisdictional countercyclical capital buffer) at a level of between 0 and 2.5 per cent of total risk-weighted assets.

~~41.34.~~ APRA will publish any decision to set, or increase, the level of the Australian jurisdictional countercyclical capital buffer up to 12 months before the date from which it applies. Any decision by APRA to reduce the level of the Australian jurisdictional countercyclical capital buffer will take effect immediately.

~~42.35.~~ The ADI-specific countercyclical capital buffer is to be applied by extending the range of the capital conservation buffer. Capital distribution constraints, as set out in Attachment B to this Prudential Standard, will apply if an ADI's Common Equity Tier 1 Capital ratio falls within the extended capital buffer range (consisting of the capital conservation buffer plus the ADI-specific countercyclical capital buffer).

### Minimum Leverage-leverage ratio requirement

~~36.~~ Paragraphs ~~37 to 40~~ and Attachment D to this Prudential Standard, do not apply to [simple ADIs].

~~37.~~ An ADI must calculate its leverage ratio in accordance with Attachment D to this Prudential Standard. Where an ADI:

~~(a)~~ is a member of a Level 2 group, the minimum leverage ratio requirement will apply only at Level 2; and

~~(a)(b)~~ is not a member of a Level 2 group, the minimum leverage ratio requirement will apply at Level 1.

~~43.38.~~ ~~an An IRB ADI with approval from APRA to use the internal ratings-based (IRB) approach to credit risk (IRB ADI) must, at all times, determine its leverage ratio in accordance with Attachment D; maintain a minimum leverage ratio of 3.5 per cent.~~

~~44.39.~~ A standardised ADI must, at all times, maintain a minimum leverage ratio of 3.0 per cent.

~~45.40.~~ APRA may require an ADI to maintain a higher minimum leverage ratio.

~~(a)~~ For the purposes of making the leverage ratio disclosures in Prudential Standard APS 330 Public Disclosure,

### **Reductions in capital**

~~46.41.~~ An ADI or authorised NOHC (as applicable) must obtain APRA's written approval prior to making any planned reduction in capital, whether at Level 1 or Level 2.

~~47.42.~~ A planned reduction in an ADI's capital includes:

- (a) a share buyback or the redemption, repurchase or repayment of any qualifying Common Equity Tier 1 Capital, Additional Tier 1 Capital and **Tier 2 Capital** instruments issued by the ADI (or by other entities included in the calculation of the ADI's Level 2 capital ~~adequacy~~);<sup>7</sup>
- (b) trading in the ADI's own shares or capital instruments outside of any arrangement agreed with APRA in accordance with Prudential Standard *APS 111 Capital Adequacy: Measurement of Capital* (APS 111); and
- (c) the aggregate amount of dividend payments on ordinary shares that exceeds an ADI's after-tax earnings after taking into account any payments on more senior capital instruments, in the financial year<sup>8</sup> -to which they relate.<sup>9</sup>

~~48.43.~~ An ADI or authorised NOHC (as applicable) proposing a capital reduction (whether at Level 1 or Level 2) must provide APRA with a forecast showing, at the respective Levels, the projected future capital position after the proposed capital reductions. The forecast should extend for at least two years.

~~49.44.~~ An ADI must satisfy APRA that the ADI's capital, at Level 1 and Level 2 as appropriate, will remain adequate for its future needs after a proposed reduction.

### Notification requirements

~~50.45.~~ An ADI or an authorised NOHC (as applicable) must notify APRA, in accordance with section 62A of the Banking Act, of any breach or prospective breach of the capital requirements contained in this Prudential Standard and inform APRA of any remedial actions taken or planned to deal with the breach.

~~51.46.~~ An ADI or an authorised NOHC (as applicable) must inform APRA as soon as practicable of any:

- (a) significant departure from its ICAAP;
- (b) concerns it has about its capital adequacy (including projected losses), whether at Level 1 or Level 2, and the measures it proposes to take to address these concerns;
- (c) indication of significant adverse changes in market pricing of, or trading in, the capital instruments of the ADI or group of which it is a member (including pressures on the ADI to purchase its own capital instruments); and

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<sup>7</sup> [For the avoidance of doubt, this does not include the repayment of a Tier 2 Capital instrument upon its contractual maturity date.](#)

<sup>8</sup> 'Financial year' means a period of 12 consecutive months covered by one or more sets of publicly available operating results preceding the date of the proposed payment of dividend or interest. For example, where an ADI makes available half-yearly operating results, a financial year will refer to the preceding two publicly available half-yearly operating results for the ADI.

<sup>9</sup> [This includes distributions on mutual equity interests which are also subject to the limits set out in Attachment K to APS 111.](#)

- (d) other significant adverse changes in its capital, whether at Level 1 or Level 2.

**Adjustments and exclusions**

~~52. APRA may, by notice, adjust or exclude a specific prudential requirement in this Prudential Standard in relation to one or more specified ADIs or authorised NOHCs.<sup>40</sup>~~

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<sup>40</sup> ~~Refer to subsection 11AF(2) of the Banking Act.~~

## Attachment AA – Risk-based regulatory capital ratios

1. ~~APRA adopts's approach to the assessment of an ADI's capital adequacy is based on the risk-based capital adequacy framework set out in the Basel Committee on Banking Supervision's publications, *International Convergence of Capital Measurement and Capital Standards: A Revised Framework* (Basel II), revised in June 2006 and *A global regulatory framework for more resilient banks and banking systems* (Basel III), released in December 2010 and revised in June 2011.~~
2. ~~Consistent with Basel II and Basel III, the approach provides for a The quantitative measure of calculating an ADI's risk-based capital adequacy requirement includes and focuses on:~~
  - (a) ~~the credit risk associated with an ADI's on balance sheet and off balance sheet exposures (refer to Prudential Standard APS 112 Capital Adequacy: Standardised Approach to Credit Risk (APS 112) and Prudential Standard APS 113 Capital Adequacy: Internal Ratings-based Approach to Credit Risk (APS 113), as applicable);~~
  - (b) ~~the operational risk associated with an ADI's banking activities (Prudential Standard APS 114 Capital Adequacy: Standardised Approach to Operational Risk (APS 114) and Prudential Standard APS 115: Advanced Measurement Approaches to Operational Risk (APS 115), as applicable);~~
  - (c) ~~the market risk arising from an ADI's trading activities (*Prudential Standard APS 116 Capital Adequacy: Market Risk* (APS 116));~~
  - (d) ~~where applicable, the interest rate risk arising from normal financial intermediation, as distinct from trading activities (*Prudential Standard APS 117 Capital Adequacy: Interest Rate Risk in the Banking Book (Advanced ADIs)* (APS 117));~~
  - (e) ~~the risks associated with securitisation in accordance with *Prudential Standard APS 120 Securitisation* (APS 120); and~~
  - (f) ~~the amount, form and quality of capital held by an ADI to act as a buffer against these and other exposures.~~
- 3.1. An ADI's Tier 1 Capital is the sum of its Common Equity Tier 1 Capital and Additional Tier 1 Capital. Its Total Capital is the sum of Tier 1 Capital and Tier 2 Capital. The criteria for inclusion in Common Equity Tier 1 Capital, Additional Tier 1 Capital and Tier 2 Capital are set out in APS 111.
- 4.2. Under APRA's risk-based capital adequacy framework, an ADI's capital adequacy is measured by means of risk-based capital ratios calculated by dividing

each of its Common Equity Tier 1 Capital, Tier 1 Capital and Total Capital by its total risk-weighted assets. That is:

$$\text{Common Equity Tier 1 Capital ratio} = \frac{\text{Common Equity Tier 1 Capital}}{\text{Total risk-weighted assets}}$$

$$\text{Tier 1 Capital ratio} = \frac{\text{Tier 1 Capital}}{\text{Total risk-weighted assets}}$$

$$\text{Total Capital ratio} = \frac{\text{Total Capital}}{\text{Total risk-weighted assets}}$$

where total risk-weighted assets are calculated as the sum of:

- (a) risk-weighted on-balance sheet and off-balance sheet assets determined in accordance with [Prudential Standard APS 112 Capital Adequacy: Standardised Approach to Credit Risk \(APS 112\)](#);
- (b) risk-weighted [on-balance sheet and off-balance sheet](#) assets determined ~~under~~ [in accordance with Prudential Standard APS 113 Capital Adequacy: Internal Ratings-based Approach to Credit Risk \(APS 113\)](#);
- (c) [risk-weighted on-balance sheet and off-balance sheet assets determined in accordance with Prudential Standard APS 120 Securitisation \(APS 120\)](#); and
- ~~(b)~~(d) 12.5 times the sum of the capital charges determined under [Prudential Standard APS 114 Capital Adequacy: Standardised Approach to Operational Risk](#)~~APS 114~~, [Prudential Standard APS 115: Advanced Measurement Approaches to Operational Risk](#)~~APS 115~~, [Prudential Standard APS 116 Capital Adequacy: Market Risk \(APS 116\)](#), ~~and~~ [Prudential Standard APS 117 Capital Adequacy: Interest Rate Risk in the Banking Book \(Advanced ADIs\)](#)~~APS 117~~ and [Prudential Standard APS 180 Capital Adequacy: Counterparty Credit Risk \(APS 180\)](#); ~~and~~
- ~~(c)~~ [risk-weighted assets determined under APS 120](#),

to the extent that each of these Prudential Standards applies to the ADI.

## Attachment **BB** – Constraints on capital distributions

- Capital distribution constraints apply when an ADI's Common Equity Tier 1 Capital ratio is within the capital buffer (CB) range (consisting of the capital conservation buffer plus any countercyclical capital buffer). The ~~capital buffer~~CB range is divided into four quartiles for the purposes of determining the minimum capital conservation ratios, as set out in Table 1.

**Table 1: Minimum capital conservation standards**

Minimum capital conservation standards	
Common Equity Tier 1 Capital ratio	Minimum capital conservation ratios (expressed as a percentage of earnings)
Within first quartile of buffer PCR to $\leq$ (PCR + 0.25CB)	100
Within second quartile of buffer > (PCR + 0.25CB) to $\leq$ (PCR + 0.50CB)	80
Within third quartile of buffer > (PCR + 0.50CB) to $\leq$ (PCR + 0.75CB)	60
Within fourth quartile of buffer > (PCR + 0.75CB) to $\leq$ (PCR + CB)	40
Above top of buffer > (PCR + CB)	0

- The minimum capital conservation ratios in Table 1 represent the percentage of earnings that an ADI ~~must not be unable to~~ distribute ~~where-if~~ its Common Equity Tier 1 Capital ratio falls within the corresponding quartile. ~~Where-If~~ the Common Equity Tier 1 Capital ratio falls within the first quartile, ~~an-the~~ ADI must also cease all Tier 1 Capital distributions.
- Earnings are defined for the purposes of this Attachment as distributable profits calculated prior to the deduction of elements subject to the restriction on distributions. Earnings are calculated after the tax that would have been reported had none of the distributable items been paid. As such, any tax impact of making such distributions is reversed out. An ADI that does not have positive earnings and has a Common Equity Tier 1 Capital ratio less than the sum of its Common Equity Tier 1 PCR plus the capital conservation buffer must not make positive net distributions.

4. Payments made by an ADI that do not result in a depletion of Common Equity Tier 1 Capital are not considered to be distributions for the purposes of this Attachment. APRA may impose restrictions on capital distributions ~~in accordance with paragraph 42(c) of this Prudential Standard,~~ even where an ADI's Common Equity Tier 1 Capital ratio is above the capital conservation buffer.
5. APRA may impose limits on the period in which an ADI may operate within the capital conservation buffer range, on a case-by-case basis.



## Attachment CC – Countercyclical capital buffer

1. An ADI must calculate the ADI-specific countercyclical capital buffer requirement as the weighted average of the jurisdictional countercyclical capital buffers that are applied by the regulatory authorities in jurisdictions in which the ADI has exposures.
2. The weighting applied to the jurisdictional countercyclical capital buffer in each jurisdiction will be the risk-weighted amount of an ADI's private sector credit exposures in that jurisdiction, divided by the risk-weighted amount of the ADI's private sector credit exposures across all jurisdictions, where:
  - (a) private sector credit exposures are:
    - (i) on-balance sheet assets, off-balance sheet exposures and on- and off-balance sheet securitisation and resecuritisation exposures determined under APS 112, APS 113 or APS 120, as relevant; and
    - (ii) exposures for which an ADI calculates a trading book capital charge for specific risk including equity specific risk, interest rate specific risk, incremental risk, securitisation and resecuritisation under APS 116,
  - (b) to private sector counterparties, excluding ADIs (and equivalent overseas deposit-taking institutions) but including other financial institutions; and
  - (c) the risk-weighted amount of an ADI's private sector credit exposures is the sum of:
    - (i) the risk-weighted assets for the assets and exposures in 2(a)(i); and
    - (ii) the risk-weighted equivalent trading book capital charges for exposures in 2(a)(ii).
3. When determining the jurisdiction to which a private sector credit exposure relates, ADIs must use an ultimate risk basis, where possible. An ADI must use the jurisdiction where the guarantor of the exposure resides, not where the exposure has been booked.
4. APRA may require an ADI to apply a higher countercyclical capital buffer for a particular jurisdiction than may be imposed by the host authority in that jurisdiction.
5. For Level 2 purposes, the ADI-specific countercyclical capital buffer must cover all exposures incurred in relevant jurisdictions, even though the business may be undertaken by a member of the Level 2 group that is not itself an ADI or equivalent overseas deposit-taking institution.
6. For the Value-at-Risk (VaR) for specific risk, the incremental risk charge and the comprehensive risk measurement charge included in calculating the ADI-specific countercyclical capital buffer, an ADI must consult with APRA to develop an

approach that would translate these charges into individual instrument risk-weights that would then be allocated to the geographic location of the specific counterparties that make up the charge.

## Attachment D – Leverage ratio

This Attachment does not apply to [simple ADIs].

1. An ~~IRB~~-ADI must calculate its leverage ratio as follows:

$$\text{Leverage ratio} = \frac{\text{Tier 1 Capital}}{\text{Exposure Measure}}$$

where:

- (a) Tier 1 ~~capital~~-Capital is determined in accordance with APS 111; and
  - (b) the exposure measure is determined in accordance with paragraphs 3 to 29 of this Attachment and is calculated as the sum of:
    - (i) on-balance sheet exposures;
    - (ii) non-market related off-balance sheet exposures;
    - (iii) derivative exposures; and
    - ~~(iv)~~ securities financing transaction (SFT) exposures.
2. Unless otherwise specified in this Attachment, an ADI~~The exposure measure must follow **Australian Accounting Standards** in calculating its exposure measure,~~ subject to the following:
    - ~~(i) on-balance sheet, non-derivative exposures must be included in the exposure measure net of specific provisions or accounting valuation adjustments (e.g. accounting credit valuation adjustments);~~
    - ~~(b)(a) unless specified otherwise, an ADI must not take account of physical or financial collateral, guarantees or other credit risk mitigation techniques must not be taken into account by an ADI to reduce the exposure measure; and~~
    - (b) netting of ~~loans-assets~~ and ~~deposits-liabilities~~ is not permitted; and
    - (c) securitisation exposures which meet the operational requirements for regulatory capital relief, as set out in APS 120, may be excluded from the exposure measure. All other securitisation exposures, including funding-only and synthetic securitisations, must be included in the exposure measure.-
  3. APRA may temporarily exclude central bank reserves from the leverage ratio exposure measure in exceptional macroeconomic circumstances. If APRA excludes central bank reserves, it may increase the minimum leverage ratio requirement commensurately to offset the impact of the exclusion. In the event that APRA excludes central bank reserves from the calculation of the exposure

measure, an ADI must disclose the impact of the exclusion, as well as its leverage ratio calculated without the benefit of the exclusion.

3. —

4. — The leverage ratio must be calculated on a Level 2 basis or, where a Level 2 basis is not applicable, on a Level 1 basis.

### **Standardised ADIs**

5.4. A standardised ADI must calculate its leverage ratio exposure measure in accordance with paragraphs 5 to 13 of this Attachment.

*An IRB ADI must calculate the exposure measure as the sum of:*

*on-balance sheet exposures;*

*derivatives exposures;*

*securities financing transaction (SFT) exposures;<sup>††</sup> and*

*other off-balance sheet exposures.*

#### *On-balance sheet exposures*

6.5. In determining its on-balance sheet exposures, an ADI must include all balance sheet assets, including any on-balance sheet collateral for derivatives and SFTs.

6. Balance sheet assets deducted from Common Equity Tier 1 Capital and Additional Tier 1 Capital for the purposes of regulatory adjustments under APS 111 ~~must~~ may be deducted from the exposure measure.;

(a) — ~~and~~

7. Liability items must not be deducted from the exposure measure, including any gains and losses on fair value liabilities, or accounting value adjustments on derivative liabilities due to changes in an ADI's own credit risk.

8. On-balance sheet assets may be included in the exposure measure at their accounting values net of:

(a) associated specific provisions; and

(b) general provisions or general reserves for credit losses held against future, presently unidentified losses, which are freely available to meet losses, where these provisions or reserves have reduced or otherwise been

<sup>††</sup> — For the purpose of calculating the leverage ratio as set out in this attachment, SFTs are transactions such as repurchase agreements, reverse repurchase agreements, and security lending and borrowing, and margin lending transactions, where the value of the transactions depends on the market valuation of securities and the transactions are typically subject to margin agreements.

deducted from Tier 1 Capital. In determining its on-balance sheet exposures, an IRB ADI must apply the following treatments:

(e)(b) include all balance sheet assets, including on-balance sheet derivatives collateral and collateral for SFTs, with the exception of on-balance sheet derivatives and SFT assets that are covered in paragraphs 7 to 28 below;

9. Where an IRB ADI holds assets in a fiduciary capacity, these assets may be excluded from the exposure measure provided that the assets meet the accounting criteria for derecognition and, where applicable, the accounting criteria for deconsolidation.

#### Non-market-related off-balance sheet exposures

10. To determine non-market-related off-balance sheet exposures for the purposes of the leverage ratio, an ADI must apply credit conversion factors (CCFs) to the gross notional amounts of off-balance sheet items. An ADI must apply the CCFs set out in Table 1 of Attachment B to APS 112.

11. For any off-balance sheet securitisation exposures, an ADI must apply the relevant CCFs as set out in paragraph 43 of APS 120.

12. Specific and general provisions that have decreased Tier 1 Capital may be deducted from the credit exposure equivalent amount (i.e. the exposure amount after the application of the relevant CCF). However, the resulting off-balance sheet equivalent amount for these exposures cannot be less than zero.

#### Derivative and securities financing transaction exposures

13. An ADI must calculate its derivative and SFT exposures in accordance with Australian Accounting Standards, subject to paragraph 2 of this Attachment.

### **IRB ADIs**

#### On-balance sheet exposures

7.14. An IRB ADI must calculate its on-balance sheet exposures in accordance with paragraphs 5 to 9 and 15 to 17 of this Attachment.

#### **Unsettled trades**

15. An IRB ADI must account for regular-way purchases or sales of financial assets that have not been settled on the following basis:

(a) ADIs which apply trade date accounting must reverse out any offsetting between cash receivables for unsettled sales and cash payables for unsettled purchases of financial assets. Thereafter, ADIs may offset between those cash receivables and cash payables (irrespective of whether such offsetting is permitted under Australian Accounting Standards) only if all of the following conditions are met:

- (i) the financial assets bought and sold that are associated with cash payables and receivables are measured at fair value through the income statement and included in the ADI's trading book in accordance with Attachment A to APS 116; and
  - (ii) the transactions of the financial assets are settled on a delivery-versus-payment basis;
- (b) ADIs which apply settlement date accounting, must apply the treatment set out in paragraphs 18 and 19 of this Attachment.

### Cash pooling

16. If an IRB ADI uses cash pooling arrangements which combine the credit and debit balances of several individual participating customer accounts into a single account balance, the IRB ADI may recognise the single account balance in its calculation of the exposure measure if:
- (a) the balances are transferred on at least a daily basis; and
  - (b) the IRB ADI cannot be held liable for the balances on an individual basis upon the transfer, i.e. the IRB ADI can only be held liable for a single claim based on the single account.
- 8-17. If cash pooling arrangements do not meet the conditions set out in paragraph 16 of this Attachment, the individual balances of the participating customer accounts must be reflected separately in the exposure measure.

### Non-market-related off-balance sheet exposures

18. An IRB ADI must determine its non-market-related off-balance sheet exposures in accordance with paragraphs 10 to 12 and, if relevant, paragraph 19 of this Attachment.
19. If the exposure amount relates to an unsettled regular-way financial asset purchase (i.e. the commitment to pay) that is accounted for at settlement date, an ADI must apply a CCF of 100 per cent. An ADI may offset commitments to pay for unsettled purchases and cash to be received for unsettled sales provided the following conditions are met:
- (a) the financial assets bought and sold that are associated with the cash payables and receivables are included in the ADI's income statement at fair value and allocated to the ADI's trading book in accordance with Attachment A to APS 116; and
  - (b) the transactions of the financial assets are settled on a delivery-versus-payment basis.

*Derivative exposures*

- ~~9. In determining its derivatives exposures, including where an IRB ADI sells protection using a credit derivative, an ADI must apply the treatments in paragraphs 8 to 20 of this Attachment.~~
20. For the purpose of calculating the exposure measure, an IRB ADI must apply the specific treatment set out in paragraphs 21 to 42 of this Attachment to any derivatives exposures.

**Treatment of derivatives**

21. An IRB ADI must calculate its exposures associated with all derivative transactions, including where it sells protection using a credit derivative, as:

$$\text{exposure measure} = 1.4 * (RC + PFE)$$

where:

RC = the replacement cost, calculated according to paragraph 25 of this Attachment; and

PFE = the potential future exposure, calculated according to paragraphs 26 and 27 of this Attachment.

- ~~10-22. An IRB ADI must calculate its exposure to a single derivatives transaction not covered by an eligible bilateral netting agreement by applying the formula in paragraph 21 of this Attachment to each transaction separately.~~

23. An IRB ADI must calculate its exposure to derivatives transactions covered by an eligible bilateral netting agreement by applying the formula in paragraph 21 of this Attachment at the netting set level.<sup>12</sup>

- ~~24. The exposure of derivatives transactions covered by an eligible bilateral netting agreement is calculated according to paragraph 9 of this Attachment. For a single derivatives transaction not covered by an eligible bilateral netting agreement, the exposure is calculated according to paragraph 10 of this Attachment. For the purposes of this Attachment calculating the leverage ratio exposure measure, an eligible bilateral netting agreement is one that meets the criteria in paragraphs 7 to 12 in Attachment J-1 to APS 112.<sup>13</sup>~~

**Written credit derivatives are subject to an additional treatment, as set out in paragraphs 17 to 20 of this Attachment. Calculation of the replacement cost**

25. The RC of a transaction or netting set is measured as follows:

<sup>12</sup> Netting set is defined in paragraph 8(s) of APS 180.

<sup>13</sup> For the purpose of calculating the leverage ratio exposure measure, ~~Crosscross-product netting (i.e. between derivatives and SFTs) is not permitted. Where an ADI has a cross-product netting agreement that meets the criteria of an eligible bilateral netting agreement, it may perform netting separately in each product category provided all other conditions for netting in this product category are met.~~

$$RC = \max \{V - CVM_r + CVM_p, 0\}$$

where:

V = the market value of the individual derivative transaction, or of the derivative transactions in a netting set;

CVM<sub>r</sub> = the cash variation margin received that meets the conditions set out in paragraph 30 of this Attachment and for which the amount has not already reduced the market value of the derivative transaction V under Australian Accounting Standards; and

CVM<sub>p</sub> = the cash variation margin provided by the ADI that meets the conditions set out in paragraph 30 of this Attachment and for which the amount has not already increased the market value of the derivative transaction V under Australian Accounting Standards.

### Calculation of the potential future exposure

26. The PFE for derivative exposures must be calculated in accordance with Attachment D to APS 180. Specifically,

$$PFE = m * AddOn_{aggregate}$$

where:

m = 1; and

AddOn<sub>aggregate</sub> = the aggregation of all add-on components calculated in accordance with Attachment D to APS 180. The maturity factor used must reflect the treatment for margined and unmargined transactions.

27. Written options must be included in the leverage ratio exposure measure, even where the exposure at default may be set to zero under APS 180.

~~11.—~~

- ~~12.— The exposure of transactions covered by an eligible bilateral netting agreement must be calculated as follows:~~

$$exposure\ measure = NRC\ (if\ positive) + PFCE_{adj}$$

where:

~~NRC = the net mark to market replacement cost of all netted transactions. It is defined to be the same as the net current credit exposure (NCCE), and must be obtained according to paragraph 29 in Attachment J to APS 112; and~~

~~PFCE<sub>adj</sub> is the gross potential future credit exposure add-on adjusted for netting. PFCE<sub>adj</sub> must be obtained according to paragraphs 30 to 35 in Attachment J to APS 112.~~



~~13. The exposure of a single derivatives transaction not covered by an eligible bilateral netting agreement must be calculated as follows:~~

$$\text{exposure measure} = RC \text{ (if positive)} + PFCE$$

where:

~~RC = the replacement cost of the agreement (obtained by marking to market), where the contract has a positive value; and~~

~~PFCE = the potential future credit exposure add-on amount over the remaining life of the contract. PFCE must be obtained according to paragraphs 2, 4 to 8 and 10 to 11 in Attachment B to APS 112.~~

### Treatment of related collateral

~~14.28. When calculating the exposure amount for derivatives by applying paragraphs 8 to 10 of this Attachment, an An IRB ADI must not reduce the its exposure measure by the amount by of any derivatives collateral received from the a counterparty.~~

~~15.29. An IRB ADI must increase its exposure measure by gross up their exposure measure by the amount of any derivatives collateral provided by it to a counterparty, notwithstanding that where the provision of that collateral has reduced the value of its balance sheet assets under Australian Accounting Standards.~~

### Treatment of cash variation margin

~~16.30. The following conditions must be met for the cash portion of variation margin exchanged between counterparties to be treated as a form of pre-settlement payment: An IRB ADI may reduce its exposure measure by treating the cash portion of variation margin exchanged between counterparties as a form of pre-settlement payment, if the following conditions are met:~~

- ~~(a) for trades not cleared through a qualifying central counterparty (QCCP),<sup>14</sup> the cash received by the recipient counterparty is must not be segregated. Cash variation margin would satisfy the non-segregation criteria if the recipient counterparty is not subject to any restrictions by law, regulation or agreement on the counterparty's ability to use the cash received;~~
- ~~(b) variation margin is calculated and exchanged on a daily basis based on mark-to-market valuation of derivatives positions. In order to meet this requirement, derivative positions must be valued daily and cash variation margin must be transferred at least daily to the counterparty;~~

<sup>14</sup> QCCP is defined in paragraph 9.11(1) of APS 112.

- (c) the cash variation margin is received in a currency specified in the derivatives contract, governing master netting agreement (MNA),<sup>15</sup> credit support annex to the qualifying MNA or as defined by any netting agreement with a central counterparty (CCP)~~the same currency as the currency of settlement of the derivatives contract;~~<sup>16</sup>
- (d) variation margin exchanged is the full amount that would be necessary to ~~fully~~ extinguish the mark-to-market exposure of the derivatives subject to the threshold and minimum transfer amounts applicable to the counterparty;<sup>17</sup> and
- (e) derivatives transactions and variation margins are covered by a single master netting agreement (MNA), between the legal entities that are the counterparties in the derivatives transaction.<sup>18,19</sup>The MNA must explicitly stipulate that the counterparties agree to settle on a net basis any payment obligations covered by the MNA such a netting agreement, taking into account any variation margin received or provided if a credit event occurs involving either counterparty. The MNA must be legally enforceable and effective in all relevant jurisdictions, including in the event of default and bankruptcy or insolvency.

~~(e) —~~

~~17.31. If the conditions in paragraph 3013 of this Attachment are met, and an IRB ADI may use the cash portion of its variation margin received to reduce the replacement cost portion of the leverage ratio exposure measure, and the receivables assets from cash variation margin provided may be deducted from the leverage ratio exposure measure as follows:~~

- (a) ~~if the ADI receives cash variation margin from a counterparty, it may reduce only the replacement cost portion RC<sup>20</sup> (but not the PFE component i.e. NRC or RC defined in paragraphs 9 or 10 in this Attachment) of the exposure amount of the derivatives asset consistent with paragraph 25 of this Attachment by the amount of cash received if the positive mark-to-market value of the derivatives contract(s) has not already been reduced~~

<sup>15</sup> ~~MNA includes any netting agreement that provides legally enforceable rights of offset and also satisfies the criteria for bilateral netting agreements as set out in paragraphs 7 to 17 of Attachment I to APS 112. A master MNA, which is an overarching agreement that provides a legally enforceable right to net across more than one MNA, may be deemed to be a single MNA.~~

<sup>16</sup> ~~CCP is defined in paragraph 11(a) of APS 112.~~

<sup>17</sup> ~~In situations where a margin dispute arises, the amount of non-disputed variation margin that has been exchanged can be recognised.~~

<sup>18</sup> ~~MNA is defined the same way as the bilateral netting agreement as set out in paragraphs 7 to 12 in Attachment J to APS 112, except that MNA in this case must also include any 'netting agreement' that provides legally enforceable rights of set-off.~~

<sup>19</sup> ~~A master MNA is a single MNA for this purpose.~~

<sup>20</sup> ~~Cash variation margin received must not be used to reduce the PFCE amount or either the numerator or the denominator of the net to gross ratio (NGR) as defined in paragraph 33 in Attachment J to APS 112.~~

~~by the same amount of cash variation margin received under Australian Accounting Standards; and~~

- (b) ~~if the ADI provides~~ cash variation margin to a counterparty, it may deduct the resulting receivable from its ~~leverage ratio~~ exposure measure, where the cash variation margin has been recognised as an asset ~~under in accordance with~~ Australian Accounting Standards, ~~and instead include the cash variation margin provided in the calculation of the RC consistent with paragraph 25 of this Attachment.~~

### Treatment of clearing services

32. When an IRB ADI acting as a clearing member (CM)<sup>21</sup> offers clearing services to clients, ~~the ADI's~~ trade exposures<sup>22</sup> to the ~~central counterparty (CCP)~~<sup>23</sup> ~~must be included in its exposure measure by applying the same treatment as for any other type of derivative transaction.~~<sup>24</sup> ~~Trade exposures to a CCP that arise when the clearing member the ADI is obligated to reimburse the client for any losses suffered due to changes in the value of its transactions in the event that the CCP defaults, must be captured by applying the same treatment that applies to any other type of derivatives transactions.~~

~~18.33.~~ When ~~the an~~ IRB ADI, ~~acting as a CM based on the contractual arrangements with the client,~~ is not ~~required contractually obligated~~ to reimburse the client for any losses suffered ~~due to changes in the value of its transactions in the event that a QCCP defaults, the clearing member ADI must may exclude not include~~ the resulting trade exposures to the QCCP ~~from its~~ ~~the leverage ratio~~ exposure measure.

34. When a client enters directly into a derivatives transaction with ~~the a~~ CCP, and ~~an clearing member~~ IRB ADI acting as a CM guarantees the performance of ~~its clients' derivatives trade exposures to the CCP~~ the client's transaction to the CCP, the ADI must calculate its related leverage ratio exposure resulting from the guarantee as a derivatives exposure ~~as set out in in accordance with~~ paragraphs 218 to 314 of this Attachment, as if it had entered directly into the transaction with the client, ~~including with regard to the receipt or provision of cash variation margin.~~

35. ~~If an entity falls within the Level 2 group of the IRB ADI acting as a CM, trades between that entity and the ADI are eliminated in the course of consolidation and the ADI retains an exposure to the CCP. In this case, the transaction with the CCP will be considered proprietary for the IRB ADI acting as a CM, and the exemption set out in paragraph 33 of this Attachment will not apply.~~

<sup>21</sup> 'Clearing member' is defined in paragraph 91(b) of APS 112.

<sup>22</sup> ~~For the purposes of paragraphs 32 to 35 15 and 16 of this Attachment, 'trade exposures' includes initial margin irrespective of whether or not it is posted in a manner that makes it remote from the insolvency of the CCP.~~

<sup>23</sup> ~~CCP is defined in paragraph 9(a) of APS 112.~~

<sup>24</sup> ~~For the purposes of paragraphs 32 to 35 of this Attachment, trade exposures includes initial margin irrespective of whether or not it is posted in a manner that makes it remote from the insolvency of the CCP.~~

~~19.~~

### Additional treatment for written credit derivatives

~~20.36.~~ ~~In addition to the CCR exposure, written credit derivatives also create credit exposure to the underlying reference entity. It is appropriate to treat written credit derivatives consistently with cash instruments (e.g. loans, bonds) for the purposes of the exposure measure. For written credit derivatives, an IRB ADI must apply the additional treatment set out in paragraphs 36 to 42 of this Attachment. The additional credit exposure must be calculated according to paragraphs 18 and 19 of this Attachment. For the purposes of this Attachment, written credit derivative refers to a broad range of credit derivatives through which a bank effectively provides credit protection and is not limited solely to credit default swaps and total return swaps.~~

37. To capture the credit exposure to the underlying reference entity, the effective notional amount<sup>25</sup> referenced by a written credit derivative must be included in the exposure measure unless:

- (a) the written credit derivative is included in a transaction cleared on behalf of a client of the ADI acting as a CM; and
- (b) the transaction meets the requirements of paragraph 33 of this Attachment for the exclusion of trade exposures to the QCCP.

~~21.38.~~ The effective notional amount of a written credit derivative may ~~then~~ be reduced in one or both of the following ways:

- (a) by ~~the any~~ negative change in the fair value amount that has been incorporated into the calculation of Tier 1 Capital with respect to the written credit derivatives; and
- (b) by the effective notional amount of an offsetting purchased credit derivatives on the same reference name<sup>26</sup> provided the conditions set out in paragraph 39~~19~~ of this Attachment are satisfied.<sup>27,28</sup>

~~22.39.~~ ~~The following conditions must be satisfied if an~~An IRB ADI ~~chooses to include the deduction on~~ may reduce the effective notional amount ~~from~~ through

<sup>25</sup> The effective notional amount is obtained by adjusting the notional amount to reflect the true exposure of contracts that are leveraged or otherwise enhanced by the structure of the transaction.

<sup>26</sup> Two reference names are considered identical only if they refer to the same legal entity.

<sup>27</sup> ~~When an offsetting purchased credit derivatives transaction exists, the effective notional amount of a written credit derivative may be reduced by any negative change in fair value reflected in the ADI's Tier 1 Capital as described in subsection (a) of this paragraph, if the effective notional amount of the offsetting purchased credit protection is also reduced by any resulting positive change in fair value reflected in Tier 1 Capital.~~

<sup>28</sup> ~~When an ADI buys credit protection through a total return swap (TRS) and records the net payments received as net income, but does not record offsetting deterioration in the value of the written credit derivative (either through reductions in fair value or by an addition to reserves) reflected in Tier 1 Capital, the credit protection must not be recognised for the purpose of offsetting the effective notional amounts related to written credit derivatives.~~

the application of offsetting purchased credit derivatives as set out in paragraph 18(b) if the following conditions are satisfied:

- (a) the credit protection purchased through credit derivatives is otherwise subject to the same, or more conservative, material terms as those in the corresponding written credit derivative.<sup>29</sup> This ensures that if an ADI provides written credit protection via a credit derivative, it may only recognise offsetting from another purchased credit derivative if the purchased protection is certain to deliver a payment to the ADI in all potential future outcomes states;
- (b) the remaining maturity of the credit protection purchased through credit derivatives is equal to or greater than the remaining maturity of the written credit derivatives;
- ~~(b) the written and the offsetting purchased credit derivatives transactions must refer to the same legal~~
- (c) the credit protection purchased through credit derivatives is not purchased from a counterparty whose credit quality is highly correlated with the value of the reference obligation;
- (d) in the event that the effective notional amount of a written credit derivative is reduced by any negative change in fair value reflected in the ADI's Tier 1 Capital, the effective notional amount of offsetting credit protection purchased through credit derivatives must also be reduced by any resulting positive change in fair value reflected in Tier 1 Capital; and
- ~~(e)~~(e) the credit protection purchased through credit derivatives is not included in a transaction that has been cleared on behalf of a client and for which the effective notional amount referenced by the corresponding written credit derivative is excluded from the exposure measure under paragraph 33 of this Attachment.
- ~~(d) if an ADI purchases protection on a pool of reference names, the protection purchased must be economically equivalent to buying protection separately on each of the individual names in the pool,<sup>30</sup> and the pool of reference entities and the level of subordination in both transactions must be identical.<sup>31</sup>~~

40. Credit protection purchased on a pool of reference names may only offset credit protection sold on individual reference names if the credit protection purchased is economically equivalent to buying protection separately on each of the

<sup>29</sup> Material terms include the level of subordination/seniority, optionality, strike price, credit events, reference name and any other characteristics relevant to the valuation of the derivative.

<sup>30</sup> This would, for example, be the case if an ADI were to purchase protection on an entire securitisation structure.

<sup>31</sup> If an IRB ADI purchases protection on a pool of reference names, but the credit protection does not cover the entire pool, then offsetting must not be included for the protection sold on individual reference names. However, such purchased protections may offset sold protections on a pool provided the purchased protection covers the entirety of the subset of the pool on which protection has been sold.

individual names in the pool. If the credit protection purchased does not cover the entire pool (i.e. the protection covers only a subset of the pool, as in the case of an nth-to-default credit derivative or a securitisation tranche), no offsetting of credit protection sold on individual reference names is allowed.

41. Where an IRB ADI purchases credit protection through a total return swap and records the net payments received as net income, but does not record the offsetting deterioration in the value of the written credit derivative (either through reductions in fair value or by an addition to reserves) in Tier 1 Capital, the credit protection must not be used to offset the effective notional amounts of the written credit derivatives.
42. An IRB ADI may choose to exclude from the netting set for the calculation of PFE the portion of a written credit derivative which is not offset according to paragraph 38 of this Attachment, and for which the effective notional amount is included in the exposure measure.
- ~~23. When the effective notional amount is included in the exposure measure as described in paragraph 18 of this Attachment, and the deduction of offsetting purchased credit derivatives is not included as described in paragraph (b), an IRB ADI may apply one of the following two deductions:~~
- ~~(a) if an eligible bilateral netting contract is in place according to conditions set out in paragraph 8 of this Attachment, the ADI may deduct the individual *PFCE* add-on amount from  $PFCE_{gross}$ <sup>32</sup> which is defined in 30 to 35 of Attachment J to APS 112; or,~~
- ~~(b) when such a netting contract is not in place, the ADI may set the *PFCE* add-on amount, as defined in paragraph 10 in this Attachment, to zero.~~

### *Securities financing transaction exposures*

~~24.43. In determining its SFT exposures~~For the purpose of calculating the exposure measure, an IRB ADI must apply the specific treatment set out in paragraphs 44 to 52 of this Attachment to any SFT exposures.<sup>33</sup>~~acting as a principal must apply the treatments in paragraphs 22 to 24 in this Attachment, while an IRB ADI acting as an agent must apply the treatments in paragraphs 26 to 28. For sale accounting transactions, an ADI must apply the treatment set out in paragraph 25 of this Attachment.~~

### ADI acting as a principal

~~25.44.~~When an IRB ADI is acting as a principal in a SFT, its the leverage ratio exposure measure must include the sum of the following amounts:

<sup>32</sup> ~~However, no adjustments must be made to *NGR*, which is defined in paragraph 33 in Attachment J of APS 112.~~

<sup>33</sup> SFT is defined in paragraph 11(y) of APS 112.

- (a) gross SFT assets recognised for accounting purposes<sup>34</sup> (i.e. with no recognition of accounting netting),<sup>35</sup> adjusted as follows:
- (i) excluding the value of any securities received under an SFT, where the ADI has recognised the securities as an asset on its balance sheet; and
  - (ii) cash payables and cash receivables in SFTs with the same counterparty may be measured net if all the following criteria are met:
    - (A) transactions have the same explicit final settlement date. Transactions with no explicit end date but which can be unwound at any time by either party to the transaction are not eligible;
    - (B) the right to set-off the amount owed to the counterparty with the amount owed by the counterparty is legally enforceable both ~~currently~~ in the normal course of business and in the event of: the (i) default; (ii) insolvency; ~~and~~ (iii) bankruptcy of the counterparty; and
    - (C) the counterparties intend to settle net, settle simultaneously, or the transactions are subject to a settlement mechanism that results in the functional equivalent of net settlement; ~~that is, the cash flows of the transactions are equivalent, in effect, to a single net amount on the settlement date.~~<sup>36</sup> To achieve such equivalence, both transactions are settled through the same settlement system and the settlement arrangements are supported by cash and/or intraday credit facilities intended to ensure that settlement of both transactions will occur by the end of the business day and the linkages to collateral flows do not result in the unwinding of net cash settlement.<sup>37</sup> ~~The failure of any single securities transaction in the settlement mechanism should delay settlement of only the matching cash leg or create an obligation to the settlement mechanism, supported by an~~

<sup>34</sup> For SFT assets subject to novation and cleared through QCCPs, 'gross SFT assets recognised for accounting purposes' are replaced by the final contractual exposure, given that pre-existing contracts have been replaced by new legal obligations through the novation process. However, ADIs may only net cash receivables and cash payables with a QCCP if the criteria in paragraph 44(a)(ii) are met. Any other netting permitted by the QCCP is not permitted for the purposes of the leverage ratio.

<sup>35</sup> ~~Gross SFT assets recognised for accounting purposes must not recognise any accounting netting of cash payables against cash receivables.~~

<sup>36</sup> To achieve such equivalence, both transactions are settled through the same settlement system and the settlement arrangements are supported by cash or intraday credit facilities intended to ensure that settlement of both transactions will occur by the end of the business day and, any issues arising from the securities legs of the SFTs do not interfere with the completion of the net settlement of the cash receivables and payables. The failure of any single securities transaction in the settlement mechanism may delay settlement of only the matching cash leg or create an obligation to the settlement mechanism, supported by an associated credit facility.

<sup>37</sup> ~~This ensures that any issues arising from the securities leg of the SFTs do not interfere with the completion of the net settlement of the cash receivables and payables.~~

~~associated credit facility~~ If there is a failure of the securities leg of a transaction at the end of the window for settlement in the settlement mechanism, then this transaction and its matching cash leg must be split out from the netting set and treated gross;<sup>38</sup> and

(b) a measure of CCR calculated as the current exposure without a ~~PFCE~~-PFE add-on, calculated as follows:

(i) where a qualifying MNA as defined in paragraphs 46~~23~~ and~~to~~ 47~~24~~ of this Attachment is in place, the current exposure ( $E^*$ ) must be set to the greater of zero and the total fair value of securities and cash lent to a counterparty for all transactions included in the qualifying MNA ( $\sum E_i$ ) less the total fair value of cash and securities received from the counterparty for those transactions ( $\sum C_i$ ). This is illustrated in the following formula:

$$E^* = \max \{0, [\sum E_i - \sum C_i]\}$$

(ii) where no qualifying MNA is in place, the current exposure for transactions with a counterparty must be calculated on a transaction by transaction basis;—that is, each transaction  $i$  is treated as its own netting set, as shown in the following formula:

$$E_i^* = \max \{0, [E_i - C_i]\}$$

$E_i^*$  may be set to zero if:

(A)  $E_i$  is the cash lent to a counterparty;

(B) this transaction is treated as its own netting set; and

(C) the associated cash receivable is not eligible for the netting treatment in paragraph 44(a) of this Attachment.

45. For the purposes of paragraph 44(b) of this Attachment, the term counterparty includes not only the counterparty of the bilateral repurchase transactions, but also triparty repurchase agents that receive collateral in deposit and manage the collateral in the case of triparty repurchase transactions. Securities deposited at triparty repurchase agents are included in the total value of securities and cash lent to a counterparty (E) up to the amount effectively lent to the counterparty in a repurchase transaction. However, excess collateral that has been deposited at triparty agents but that has not been lent out may be excluded.

<sup>38</sup> ~~If there is a failure of the securities leg of a transaction in such a mechanism at the end of the window for settlement in the settlement mechanism, then this transaction and its matching cash leg must be split out from the netting set and treated gross for the purposes of the leverage ratio exposure measure.~~



~~26.46.~~ For the purpose of paragraph 44(b), A bilateral netting agreement for covering SFTs may be recognised as a qualifying MNA on a counterparty by counterparty basis only if it:

- (a) is legally enforceable in each relevant jurisdiction upon the occurrence of an event of default, regardless of whether the counterparty is insolvent or bankrupt;
- (b) provides the non-defaulting party with the right to terminate and close out in a timely manner all transactions under the agreement upon an event of default, including in the event of insolvency or bankruptcy of the counterparty;
- (c) provides for the netting of gains and losses on transactions (including the value of any collateral) terminated and closed out under it so that a single net amount is owed by one party to the other; and
- (d) allows for the prompt liquidation or set-off of collateral in the event of default.

~~27.~~ Netting across SFT positions held in the banking book and trading book will only be recognised when the netted transactions ~~fulfil the following conditions:~~

- ~~(a) all transactions are marked to market daily; and~~

~~28.47.~~ the collateral instruments used in the transactions are recognised as eligible financial collateral in the banking book, meet the conditions set out in paragraph 5 of Attachment I to APS 112.

~~48.~~ Leverage may remain with the lender of the security in an SFT whether or not sale accounting is achieved under Australian Accounting Standards. As such, where Where an IRB ADI applies sale accounting is achieved for to an SFT under in accordance with Australian Accounting Standards, the IRB ADI must reverse all sales-related accounting entries, and then calculate its exposure as if the SFT had been treated as a financing transaction under those standards (i.e. the ADI must include the sum of amounts in subparagraphs 44(a)~~22(a)~~ and 44(b)~~22(b)~~ of this Attachment for such an SFT) for the purposes of determining its exposure measure.

### ADI acting as an agent

~~29.49.~~ When-If an IRB ADI acting as an agent in an SFT provides an indemnity or guarantee to a customer or counterparty for any difference between the value of the security or cash that the customer has lent and the value of collateral that the borrower has provided, the ADI must calculate its exposure measure by applying only subparagraph 44(b)~~22(b)~~ of this Attachment.

~~50.~~ An IRB ADI is eligible to apply the exceptional treatment set out in paragraph ~~4926 in-of~~ this attachment Attachment only if the ADI's exposure to the transaction is limited to the guaranteed difference between the value of the security or cash its customer has lent, and the value of the collateral the borrower has provided. ~~Where the ADI does not own/control the underlying cash or~~

~~security resource, that resource cannot be leveraged by the ADI. In situations where~~ Where the ADI is further economically exposed (i.e. beyond the guarantee for the difference) to the underlying security or cash in the transaction,<sup>39</sup> a further exposure equal to the full amount of the security or cash must be included in the exposure measure.

~~30.51.~~ Where an IRB ADI acting as an agent provides an indemnity or guarantee to both parties involved in an SFT (i.e. securities lender and securities borrower), the ADI must calculate its exposure measure separately for each party involved in the transaction.

~~31.~~ When an IRB ADI acting as agent in an SFT does not provide an indemnity or guarantee to any of the involved parties, the IRB ADI has no exposure to the SFT, and must set the exposure measure of those SFTs to zero is not required to include those SFTs in its exposure measure.

### ~~32.~~ **Other off-balance sheet exposures**

~~(a)~~ To determine other off balance sheet exposures for the purposes of the leverage ratio, an IRB ADI must apply credit conversion factors (CCFs) to the gross notional amounts of off balance sheet items as follows:

~~(b)~~ commitments other than securitisation liquidity facilities with an original maturity up to one year and commitments with an original maturity over one year must receive a CCF of 20 per cent and 50 per cent, respectively. However, any commitments that are unconditionally cancellable at any time by the ADI without prior notice, or that effectively provide for automatic cancellation due to deterioration in a borrower's creditworthiness, will receive a CCF of 10 per cent;

~~(c)~~ direct credit substitutes, e.g. general guarantees of indebtedness (including standby letters of credit serving as financial guarantees for loans and securities) and acceptances (including endorsements with the character of acceptances) must receive a CCF of 100 per cent;

~~(d)~~ forward asset purchases, forward deposits and partly paid shares and securities, which represent commitments with certain drawdown, must receive a CCF of 100 per cent;

~~(e)~~ certain transaction related contingent items (e.g. performance bonds, bid bonds, warranties and standby letters of credit related to particular transactions) must receive a CCF of 50 per cent;

<sup>39</sup> ~~For example, due to the ADI managing collateral received in the ADI's name or on its own account rather than on the customer's or borrower's account (e.g. by on lending or managing unsegregated collateral, cash or securities). However, this does not apply to client omnibus accounts that are used by agent lenders to hold and manage client collateral provided that client collateral is segregated from the bank's proprietary assets and the bank calculates the exposure on a client by client basis.~~

~~(f) — note issuance facilities (NIFs) and revolving underwriting facilities (RUFs) must receive a CCF of 50 per cent;~~

~~(g) — for short term self liquidating trade letters of credit arising from the movement of goods (e.g. documentary credits collateralised by the underlying shipment), a CCF of 20 per cent must be applied to both issuing and confirming ADIs;~~

~~(h) — where there is an undertaking to provide a commitment on an off-balance sheet item, ADIs are to apply the lower of the two applicable CCFs; and~~

~~33.52. — off balance sheet securitisation exposures, except an eligible liquidity facility or an eligible servicer cash advance facility as set out in Attachment E to APS 120, must receive a CCF of 100 per cent. Eligible liquidity facilities must receive a CCF of 50 per cent and undrawn service cash advances or facilities that are unconditionally cancellable without prior notice must receive a 10 per cent CCF.~~