Australian Prudential Regulation Authority

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To all Authorised Deposit-taking Institutions (ADIs)

APS 210 LIQUIDITY

The purpose of this letter is to clarify the application of *Prudential Standard APS 210 Liquidity* (APS 210).

A key principle underlying APS 210 is that where two ADIs have financial contracts with each other, the treatment of these contracts for liquidity management purposes should be symmetric. That is, the liquidity characteristics of the instrument should be identical when treated as an asset and as a liability. This is true regardless of whether an ADI is subject to APRA's scenario analysis or minimum liquidity holdings (MLH) regimes.

APRA has identified instances of asymmetrical treatment in the case of term deposits. The ADI that has placed a term deposit is treating it as an asset that can be readily converted into cash but the ADI that received the deposit is treating it as a liability with a contractual final maturity.

APRA's general expectations are as follows:

- for scenario analysis ADIs, deposits from financial institutions (including those received from ADIs) are to be modelled as 100 per cent loss at the first contractual opportunity for redemption in name-crisis scenarios. The 'first contractual opportunity' is at the earliest point (which may be at call) at which the depositing ADI can request repayment of funds;

- scenario analysis ADIs are to ensure that they have in place appropriate systems and processes to capture financial institution deposits that have been granted an early repayment option, such as through a Product Disclosure Statement (PDS) or a 'high quality liquid asset (HQLA) letter[1]', in order to make certain that these deposits are correctly modelled (for name-crisis scenarios) at the first contractual maturity;

- ADIs subject to MLH requirements may classify holdings of term deposits as HQLA if the deposits mature contractually within two business days. PDS and 'HQLA letters' will not satisfy HQLA criteria in paragraph 12 of APS 210 unless the depositor has the unconditional right to redeem the funds within two business days[2]; and

[1] A 'HQLA Letter' is issued by an ADI that has received a term deposit from another ADI and generally states that the funds can be withdrawn prior to maturity and within two business days.

[2] Conditions relating to the payment of break costs and the formal process required to redeem the funds are acceptable, whilst terms such as 'in the ordinary course of business', and 'under normal business conditions' are not.

- ADIs subject to MLH requirements that accept HQLA deposits from other ADIs must deduct these deposits from their HQLA calculation, as per section 8 of ARF 210.0 Statement of High Quality Liquid Assets Calculation.

The Basel Committee for Banking Supervision is shortly to announce the final details of its new international framework for liquidity risk management, standards and monitoring. As you know, APRA supports these reforms. Under the new global liquidity standards, the need to reflect the earliest contractual maturity rather than the notional maturity will remain in place.

If you have any questions on these matters, please contact your APRA Responsible Supervisor.

Yours sincerely

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