APRA

Response to Submissions

Basel III liquidity – the net stable funding ratio and the liquid assets requirement for foreign ADIs

29 September 2016

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Preamble

In March 2016, the Australian Prudential Regulation Authority (APRA) released for consultation a discussion paper *Basel III liquidity – the net stable funding ratio and the liquid assets requirement for foreign ADIs* (March discussion paper) outlining its proposed implementation of the net stable funding ratio (NSFR) for authorised deposit-taking institutions (ADIs). In addition, the March discussion paper set out two alternatives for the future application of a liquid assets requirement for foreign ADIs and a proposal for an annual local operational capacity (LOC) assessment.

This response paper sets out APRA's response to submissions on the March discussion paper. After consideration of submissions, APRA has modified its position in a number of areas. Accompanying this paper is a draft revised *Prudential Standard APS 210 Liquidity* (APS 210) which includes APRA's updated proposed positions.

This response paper, draft revised APS 210 and *Prudential Practice Guide APG 210 Liquidity* (APG 210) are available on APRA's website at www.apra.gov.au.

Written submissions on the matters set out in this response paper and the draft revised APS 210 and APG 210 should be sent to Basel3liquidity@apra.gov.au by 28 October 2016 and addressed to:

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All information in submissions will be made available to the public on the APRA website unless a respondent expressly requests that all or part of the submission is to remain in confidence. Automatically generated confidentiality statements in emails do not suffice for this purpose. Respondents who would like part of their submission to remain in confidence should provide this information marked as confidential in a separate attachment.

Submissions may be the subject of a request for access made under the *Freedom of Information Act 1982* (FOIA). APRA will determine such requests, if any, in accordance with the provisions of the FOIA. Information in the submission about any APRA-regulated entity that is not in the public domain and that is identified as confidential will be protected by section 56 of the *Australian Prudential Regulation Authority Act 1998* and will therefore be exempt from production under the FOIA.

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Glossary

Term	Definition
ADI	Authorised deposit-taking institution
APG 210	*Prudential Practice Guide APG 210 Liquidity*
APRA	Australian Prudential Regulation Authority
APS 112	*Prudential Standard APS 112 Capital Adequacy: Standardised Approach to Credit Risk*
APS 210	*Prudential Standard APS 210 Liquidity*
ASF	Available stable funding
Banking Act	*Banking Act 1959*
Basel Committee	Basel Committee on Banking Supervision
Basel III liquidity framework	*Basel III: International framework for liquidity risk measurement, standards and monitoring*, Basel Committee, December 2010
Basel NSFR standard	*Basel III: net stable funding ratio,* Basel Committee, October 2014
CLF	Committed liquidity facility
FALAR	Foreign ADI liquid assets requirement
Foreign ADI	Has the meaning given in section 5 of the Banking Act
HQLA	High-quality liquid assets
HQLA1	Defined in paragraph 9 of Attachment A of draft APS 210
HQLA2A	Defined in paragraph 10 of Attachment A of draft APS 210
HQLA2B	Defined in paragraph 12 of Attachment A of draft APS 210
LCR	Liquidity coverage ratio
LOC	Local operational capacity
March discussion paper	*Basel III liquidity - the net stable funding ratio and the liquid assets requirement for foreign ADIs*, APRA, March 2016
MLH	Minimum liquidity holdings

Term	Definition
November 2011 discussion paper	*Implementing Basel III liquidity reforms in Australia*, APRA, November 2011
NSFR	Net stable funding ratio
Response paper	*Basel III liquidity – the net stable funding ratio and the liquid assets requirement for foreign ADIs*, APRA, September 2016
RMBS	Residential mortgage-backed securities
RSF	Required stable funding
SPV	Special purpose vehicle

Executive summary

In December 2010, the Basel Committee on Banking Supervision (Basel Committee) released *Basel III – International framework for liquidity risk measurement, standards and monitoring* (Basel III liquidity framework), which set out measures designed to strengthen the liquidity buffers and funding stability of banks, thereby promoting a more resilient global banking system. In October 2014, the Basel Committee released the final component of the Basel III liquidity framework *Basel III: net stable funding ratio* (Basel NSFR standard).

In March 2016, APRA released the discussion paper *Basel III liquidity – the net stable funding ratio and the liquid assets requirement for foreign ADIs* (March discussion paper) outlining its proposed implementation of the net stable funding ratio (NSFR) for those authorised deposit-taking institutions (ADIs) subject to the liquidity coverage ratio (LCR). In addition, the March discussion paper set out two alternatives for the future application of a liquid assets requirement for foreign ADIs and a proposal for foreign ADIs to undertake an annual local operational capacity (LOC) assessment.

APRA received 19 submissions in response to the March discussion paper. Eight submissions commented on the NSFR proposals, while 11 commented on the proposals in relation to foreign ADIs. This paper summarises the main issues raised in submissions and provides APRA's response to those issues.

Net stable funding ratio

The March discussion paper detailed APRA's proposed implementation of the NSFR, including adjustments to appropriately reflect Australian conditions.

Overall, submissions supported the objective of the NSFR that, over time, ADIs should continue to improve their stable funding profile. That said, there were a number of specific issues raised relating to the required stable funding (RSF) factor for various assets, including self-securitised assets that are eligible collateral for the committed liquidity facility (CLF) with the Reserve Bank of Australia and for residential mortgages. Submissions also raised the recognition of high-quality liquid assets 2B (HQLA2B) as part of APRA's implementation of the NSFR.

After consideration of submissions, and further consultation with a number of ADIs, APRA has amended its original proposal concerning the RSF factor for self-securitised assets eligible as collateral for the CLF. In addition, APRA proposes to allow recognition of non-Australian dollar offshore-HQLA2B for LCR purposes and hence these assets will also be able to be recognised as HQLA in an ADI's NSFR. Similarly, APRA proposes to allow certain Australian listed equities to be eligible for a 50 per cent RSF factor as opposed to the 85 per cent RSF factor that would otherwise have applied. On the issue regarding RSF factors for residential mortgages, APRA has not changed its position from that set out in the March discussion paper.

Liquid assets requirement for foreign ADIs

Submissions on the proposals for the application of a liquid assets requirement for foreign ADIs were mixed. Views were broadly correlated to business models, with less complex foreign ADIs preferring the foreign ADI liquid assets requirement (FALAR) (a modified version of the minimum liquidity holdings (MLH) regime which currently applies to smaller, less complex locally incorporated ADIs) and foreign ADIs with more complex operations preferring the 40 per cent LCR. Importantly, submissions raised numerous issues which indicate that application of the FALAR would not be as simple as originally intended and that the one-size-fits-all approach, as envisaged, may not be appropriate. In light of these issues, APRA is proposing to retain the existing 40 per cent LCR as the default liquid assets requirement for foreign ADIs. APRA will, however, consider applications for a foreign ADI to be designated as an MLH ADI.

Local operational capacity assessment

Submissions were generally supportive of the proposal for a foreign ADI to conduct an annual local operational capacity (LOC) assessment. APRA

therefore intends to proceed with this proposal as set out in the March discussion paper.

Balancing financial safety with other considerations

As part of its consideration of the introduction and application of the NSFR, and proposals for liquid asset requirements for foreign ADIs, APRA has sought to reach an appropriate balance between the objectives of financial safety and efficiency, competition, contestability and competitive neutrality; whilst promoting financial stability. In the March discussion paper, APRA noted how the proposals will deliver improved prudential outcomes and provide efficiency and competitive benefits to ADIs. Those points remain relevant regarding the revised proposals in this paper. In the revised proposals, APRA has also sought to further address implications for competitive neutrality and efficiency through the revised proposals on certain aspects of the NSFR. This will achieve greater consistency with the LCR and improved comparability on an international basis. The proposals also include appropriate flexibility in methodology for determining liquidity requirements for foreign ADIs. APRA is also proposing to remove some existing requirements in APS 210, such as the going concern analysis, which will reduce the regulatory burden on ADIs without materially compromising the financial safety of the industry.

Timetable

APRA anticipates finalising its position on these matters in late 2016 with the release of the new *Prudential Standard APS 210 Liquidity* (APS 210) and *Prudential Practice Guide APG 210 Liquidity* (APG 210). As previously indicated, the new APS 210 will commence on 1 January 2018. APRA will consult separately on proposals on reporting requirements for the NSFR and other changes in early 2017. The new reporting requirements will also take effect from 1 January 2018.

Chapter 1 — Introduction

1.1 Background

APRA's March discussion paper outlined its proposed approach to the implementation of the NSFR, including adjustments to appropriately reflect Australian conditions. In addition, APRA consulted on proposals for the application of a modified liquid assets requirement for foreign ADIs.

APRA received 19 submissions on the March discussion paper from ADIs and industry bodies. Submissions raised various issues on the proposals, with some common themes expressed by numerous respondents. This response paper sets out details of the material issues raised in submissions and APRA's response to those issues.

1.2 Net stable funding ratio

The March discussion paper detailed APRA's intended implementation of the NSFR, including adjustments to appropriately reflect Australian conditions. Eight of the 19 submissions received were in response to APRA's proposals on the implementation of the NSFR. While ADIs have increased the amount of funding from more stable funding sources in recent years, the NSFR will reinforce these improvements and ensure they are sustained over the long term. That said, ADIs still have capacity to further improve their liquidity and funding resilience. APRA's responses to issues raised on the NSFR reflect this and are intended to balance the need for improved liquidity and funding resilience of ADIs, whilst allowing for conditions particular to the Australian operating environment.

APRA is also proposing to include in APS 210 a discretion that would allow APRA to set an ADI's NSFR requirement above the minimum of 100 per cent where APRA considers it appropriate to do so, including where APRA has concerns about an ADI's liquidity risk management or is of the view that an ADI needs to improve its funding or liquidity risk profile. This is analogous to the discretion APRA has to set higher minimum capital requirements for an ADI, where warranted, based on risk profile or other prudential considerations. APRA's expectation over the medium term is that ADIs will continue to strengthen their stable funding profile.

1.3 Liquid assets requirement for foreign ADIs

In the March discussion paper, APRA proposed two alternative options for the future application of a quantitative liquid assets requirement for foreign ADIs – namely, the existing modified LCR that currently applies to foreign ADIs and a modified version of the MLH regime, which currently applies to small locally incorporated ADIs. While both options recognise limitations in applying the 100 per cent LCR to foreign ADIs, submissions were varied in their response as to the preferred options. Also, issues raised suggested the FALAR (the proposed modified version of the MLH regime) may not be as simple to implement in practice as APRA had envisaged or necessarily be appropriate for all foreign ADIs.

1.4 Local operational capacity assessment

Submissions were generally supportive of the proposal for a foreign ADI to conduct an annual LOC assessment. APRA therefore intends to proceed with this proposal as set out in the March discussion paper.

1.5 Structure of this paper

Chapter 2 sets out APRA's responses to material issues raised in submissions, and issues requiring clarification, on the NSFR proposals in the March discussion paper.

Chapter 3 sets out APRA's response to submissions in relation to the future application of a liquid assets requirement for foreign ADIs, as well as the proposed annual LOC assessment.

Chapter 4 sets out details of other changes APRA proposes to make to APS 210 and APG 210.

1.6 Timetable

APRA anticipates releasing the final revised version of APS 210 and APG 210 in late 2016. The revised version of APS 210 will apply from 1 January 2018, consistent with the Basel Committee's intended commencement date for the NSFR.

APRA will also finalise the liquidity regime for foreign ADIs in late 2016. If the proposed approach outlined in this response paper is adopted, the existing regime will continue without change for foreign ADIs, except in circumstances where a foreign ADI applies to APRA and APRA designates a particular foreign ADI as an MLH ADI.

As noted in the March discussion paper, APRA will consult separately on proposals relating to reporting requirements for the NSFR and other changes to *Reporting Standard ARS 210 Liquidity*. APRA expects to release proposed details on reporting requirements in early 2017.

Chapter 2 — Net stable funding ratio

APRA received eight submissions on its proposals relating to the introduction of the NSFR. These included submissions from both ADIs and industry bodies. Reflecting the limited scope of application of the NSFR to 15 larger, more complex ADIs, the material issues raised tended to be common across submissions. This chapter sets out the main issues raised in submissions and APRA's response to those issues including clarifications where relevant. The draft revised APS 210, released with this response paper, reflects the proposals in the March discussion paper and changes to APRA's proposed position as detailed in this paper.

2.1 Self-securitised assets

In the March discussion paper, APRA proposed treating third-party CLF-eligible debt securities as being equivalent to HQLA in determining the NSFR and applying an RSF factor of 10 per cent, reflecting the approximate RSF factor that would apply if an adequate supply of HQLA existed in Australia.

Self-securitised assets are held in special purpose vehicles (SPVs) which hold loans made by the ADI whereby the securities issued by the SPV are not sold to third parties but instead held by the ADI for use as collateral in the CLF. The March discussion paper proposed that self-securitised assets should have the same RSF factor as that attributable to the underlying loans, ranging from 65 to 100 per cent.

Comments received

Submissions argued that, for the purposes of the NSFR, APRA should allow self-securitised assets that are recognised as eligible collateral for the CLF to be treated the same as other CLF-eligible collateral, namely third-party debt securities, with an RSF factor of 10 per cent. As self-securitised assets held as collateral for the CLF effectively compensate for the lack of sufficient HQLA in Australia, submissions noted that it would not be appropriate to treat them in the same way as the underlying loans. In this respect, ADIs also argued they could be disadvantaged *vis-à-vis* their international peers which do not face the same HQLA shortfall.

APRA's response

APRA has considered the arguments made in submissions in the context of the international and domestic funding environment. Under the Basel NSFR standard and APRA's proposals, HQLA definitions generally mirror those in the LCR. Consistent with this, and reflecting the approach taken to address the current shortage of HQLA through the CLF, APRA has determined that an RSF factor of 10 per cent may be applied to self-securitised assets held as collateral for the CLF. Nevertheless, APRA's expectation over the medium term is that ADIs will continue to strengthen the stable funding for their entire loan book, including the self-securitised portion.

2.2 Use of Basel standardised credit risk weights for NSFR purposes

Under the Basel NSFR standard, in order to determine the RSF for residential mortgages, standardised risk weights in the Basel Committee's capital framework are used.[1] Specifically, an unencumbered residential mortgage with a residual maturity of one year or more that would qualify for a 35 per cent risk weight in the capital framework would receive an RSF factor of 65 per cent for NSFR purposes. If the risk weight is greater than 35 per cent the RSF factor increases to 85 per cent. APRA's risk weights, which reflect a conservative implementation of the Basel Committee's capital framework, are set out in *Prudential Standard APS 112 Capital Adequacy: Standardised Approach to Credit Risk* (APS 112).

1 As set out in the standardised approach for credit risk in *Basel II: International Convergence of Capital Measurement and Capital Standards: A Revised Framework - Comprehensive Version*, June 2006 (refer to http://www.bis.org/publ/bcbs128.htm).

Comments received

A number of submissions argued that APRA should adopt the Basel standardised risk weight for NSFR purposes, rather than those in APS 112. Submissions argued that adopting the Basel standardised risk weight of 35 per cent would more closely align with the RSF that will apply to ADIs' international peers.

APRA's response

The proposals in the March discussion paper result in some mortgages not eligible for a 35 per cent risk weight in Australia requiring more stable funding than similar loans in some other jurisdictions. This includes, for example, non-standard loans at higher loan-to-value ratios.

APRA continues to view consistency across its prudential rules as desirable. Moreover, a somewhat greater proportion of stable funding would not appear inappropriate for higher risk loans, which may be less able to be securitised or refinanced. In addition, inconsistencies across jurisdictions may reduce in the medium term following revisions to the Basel Committee's standardised approach to credit risk, expected to be finalised around the end of 2016. This may result in a narrowing of differences in risk weights across jurisdictions. APRA therefore continues to consider it appropriate to align the RSF factors for residential mortgage exposures to the standardised risk weights as set out in APS 112.

2.3 Recognition of HQLA2B

Assets are considered to be HQLA for LCR purposes if they can be easily and immediately converted into cash with little or no loss of value. The differing classes of HQLA reflect the liquidity value of the assets in that class. Under the Basel NSFR standard and APRA's proposals, HQLA definitions generally mirror those in the LCR.

Reflecting the size and depth of local debt markets, APRA has chosen not to recognise any HQLA2A in Australia - although eligible HQLA2A from other jurisdictions may be included in the LCR and NSFR calculations. APRA does not currently recognise HQLA2B from any jurisdiction. HQLA2B includes residential mortgage-backed securities (RMBS), corporate debt securities and common equity shares – all subject to various conditions as set out in the Basel framework.

In the case of listed equities, APRA previously proposed a separate NSFR category with a 50 per cent RSF for non-financial institution issued equities listed on a recognised exchange and included in a large-cap market index. This reflected the December 2010 draft version of the Basel NSFR standard, and was included in the draft version of APS 210 released in 2011. At that time, APRA was comfortable with the proposal as listed equities have superior liquidity characteristics when compared to assets that attract higher RSF factors, typically loans.

The Basel Committee created the HQLA2B category in 2013. The final Basel NSFR standard released in October 2014 did not contain a separate category for equities, rather the 50 per cent RSF was retained via their inclusion as HQLA2B. However, given APRA has not recognised HQLA2B for LCR purposes, the RSF factor for equities in the March discussion paper effectively increased from 50 per cent to 85 per cent.

Comments received

Some submissions argued that eligible HQLA2B from jurisdictions where regulatory approval of these assets has been given should be allowed to be included in the NSFR, as these assets are expected to be readily liquefiable over the one-year NSFR time-horizon. Submissions noted that failure to recognise HQLA2B means they receive an 85 per cent RSF factor, rather than a factor of 50 per cent consistent with the Basel NSFR standard. Submissions commented that given the NSFR was finalised by the Basel Committee after the LCR, and the Committee subsequently acknowledged the liquidity value of HQLA2B, APRA's decision not to recognise these assets is inconsistent with the international approach.

APRA's response

After consideration of this matter, APRA proposes to allow recognition of HQLA2B, designated as such by the relevant prudential regulator for LCR purposes and apply the corresponding 50 per cent RSF factor in the measurement of the NSFR. APRA

accepts that it is reasonable to rely on recognition of these assets in overseas jurisdictions given the relevant regulator is best placed to approve assets as HQLA2B in its own jurisdiction.

APRA's position on HQLA2B is that there are no such assets in Australia. That is, these assets do not meet the necessary liquidity criteria and are therefore not eligible for LCR, and hence NSFR, purposes. For NSFR purposes, however, APRA will provide an exception for certain Australian-listed equities and is proposing to adopt a position consistent with APRA's original 2011 proposals to allow equities, other than financial institutions or related entities, included in the ASX 200 share index to be assigned an RSF factor of 50 per cent.

2.4 Member-directed superannuation deposits

The primary means by which an ADI receives deposits via a superannuation trustee are:

- as the operating/transaction bank for a superannuation fund (i.e. collections from payroll deductions, funds awaiting distribution, transfers between funds, etc may temporarily be in the form of an operational deposit as described in the LCR);
- at the direction of a superannuation member to place money on deposit (at-call or term); or
- based on the cash allocation within an investment option.[2]

This section covers the first two of the above points for the purposes of the NSFR. The cash allocation within an investment option is considered a deposit from a financial institution and therefore must be assigned an available stable funding (ASF) factor of zero per cent for short-term deposits, 50 per cent for deposits maturing between six and 12 months and 100 per cent for deposits maturing beyond 12 months.

Currently, operational and member-directed monies deposited by superannuation funds are often classified by ADIs as short-dated financial institution deposits and, depending on the contractual terms between the trustee and the ADI, are often not recognised as a source of stable funding with an ASF factor of zero. However, treatment is not consistently applied.

Comments received

Submissions questioned the validity of applying a zero per cent ASF factor to superannuation deposits and proposed a retail treatment with a 90 per cent ASF factor. It was argued that superannuation deposits have been historically stable, even in times of stress. Further, a number of submissions argued that given the size of the superannuation system in Australia, ADIs are disadvantaged compared to their international peers. Submissions expressed the view that, while in a severe stress event a superannuation trustee would act in the interests of its members and withdraw its funds, the NSFR has a different focus - funding stability for an extended time horizon - hence, given superannuation deposits tend to be stable over a longer time-horizon, they should be recognised as such.

APRA's response

The Basel NSFR standard requires a deposit from a financial institutional to be treated as such unless it meets the criteria for treatment as a retail deposit. While acknowledging industry's view of the historic performance of superannuation deposits, APRA does not view the treatment proposed by industry of a 90 per cent ASF for either operating or member-directed superannuation as appropriate.

There is nevertheless scope for some superannuation deposits to receive a more favourable ASF treatment. In order to recognise the stable funding characteristics of certain superannuation deposits, and to clarify the treatment of these deposits, APRA notes that an ADI may:

- treat the operating or transactional portion of superannuation deposits as operational deposits under the LCR and for NSFR purposes

2 This also applies to funds other than superannuation, for example managed investment schemes.

apply a 50 per cent ASF factor if the deposits meet the definition of operational deposits in APS 210; and

- apply a 50 per cent ASF factor to member-directed deposits where the trustee cannot remove the deposit-holding ADI provider within six months and a 90 per cent ASF if the ADI cannot be removed within one year.

In all other circumstances, superannuation deposits are considered to be deposits from a financial institution, with the ASF factor corresponding to the maturity of the deposit. Where an ADI cannot determine the source of its superannuation deposits, it would be required to apply the most conservative (lowest ASF factor) treatment to those deposits.

2.5 Securitisation and covered bonds

Under the NSFR, the encumbrance of an asset is a key factor in determining the RSF factor applied to the asset. Generally, once encumbered an asset will be subject to a higher RSF factor relative to an equivalent unencumbered asset, as its liquidity value is reduced.

Comments received

Submissions argued that APRA's proposed implementation of the NSFR will have an adverse impact on securitisation and covered bond issuances due to encumbered assets being given an RSF factor of 100 per cent. It was stated that this would act as a disincentive for ADIs to undertake funding-only securitisation or to issue covered bonds. In particular, a number of submissions recommended that APRA eliminate the asymmetric RSF and ASF factors during the last six months to maturity of RMBS securitisations and covered bonds.

APRA's response

In the Australian context, this issue is most relevant when considering residential mortgage loans that, when unencumbered, attract an RSF factor of 65 per cent, which increases to 100 per cent when encumbered. The 65 per cent factor is lower than that which applies to most loans, and reflects the liquidity value of potentially raising funds by using the residential mortgage as collateral in a securitisation or covered bond transaction. Once a residential mortgage loan has been used as collateral this liquidity value no longer exists, as the loan is encumbered and cannot be used to support other fund raisings. In these circumstances an RSF factor of 100 per cent is appropriate. APRA notes this treatment is consistent with the Basel NSFR standard.

Whilst the NSFR outcome is not as favourable as that associated with long-term unsecured forms of funding, APRA expects funding-only securitisation will be considered an attractive source of funding as part of a well-diversified funding base. This is particularly the case for the largest ADIs.

While APRA recognises the ASF/RSF mismatch in the final six months of a securitisation or covered bond, this issue is not sufficiently material to warrant deviating from the Basel NSFR standard.

2.6 Derivatives

APRA's treatment of derivatives for NSFR purposes, as set out in the March discussion paper, is consistent with the Basel NSFR standard.

Comments received

Some submissions cited conditions relevant to, but not specific to, Australia such as the reliance on offshore funding and the treatment of associated derivatives. Other submissions questioned the Basel framework in general and sought specific exceptions for Australia.

APRA's response

A number of clarifications sought in submissions have been addressed in *Basel III – The Net Stable Funding Ratio: frequently asked questions*, Basel Committee, July 2016 (Basel NSFR FAQ).[3] While matters raised in relation to the treatment of derivatives have been considered by APRA, and notably the issue of the reliance of Australian ADIs on offshore funding, arguments made in

3 Refer to http://www.bis.org/bcbs/publ/d375.htm.

submissions did not identify Australia-specific conditions of sufficient materiality to warrant deviating from the Basel NSFR standard.

2.7 Holders of ADI bonds

Under the NSFR, where an ADI cannot identify the holder of its bonds, the bonds with a remaining maturity of less than six months receive an ASF factor of zero per cent.

Comments received

One submission noted that it is difficult for an ADI to track who ultimately holds its bonds which means they fall into an 'all other liabilities category' and receive a lower ASF factor. Another submission recommended that APRA allow the use of behavioural modelling to determine bond-holdings which would be based on the primary-issue holder and agreed with APRA on an annual basis.

APRA's response

The proposed categorisation of ADI bonds, as set out in the March discussion paper, is consistent with the Basel NSFR standard. APRA proposes to maintain consistency with the Basel NSFR standard; that is, if an ADI cannot trace the ownership of tradable debt instruments it issues (with a remaining maturity of less than six months) then the instruments must be given a zero per cent ASF factor. That said a large proportion of bonds issues by Australian ADIs are held by other financial institutions. These funding instruments would otherwise be subject to a zero per cent ASF under the Basel NSFR standard where they have a residual maturity of less than six months. APRA has considered the suggestion of behavioural modelling but does not consider this to be compliant with the Basel NSFR standard.

2.8 Maturity of assets

In the March discussion paper, APRA proposed that the maturity of an asset will be taken to be the latest possible date at which the asset could mature. It was further proposed that where an asset does not have a defined maturity, the asset should be classified as having a residual maturity of greater than or equal to one year and be assigned an RSF factor on this basis.

Comments received

One submission noted that a number of standard lending products have no contractual maturity, but are subject to a minimum level of principal and interest payments (e.g. mortgage facilities, credit cards, overdrafts).

APRA's response

In the draft APS 210, APRA has clarified that an ADI may assign that portion of an asset with no stated maturity but with a minimum required payment to the relevant maturity bucket and for the corresponding RSF factor to be applied for NSFR purposes. [Note: This treatment is consistent with Q.25 of the Basel NSFR FAQ (issued July 2016)].[4]

2.9 Discretion to increase the NSFR requirement

APRA is proposing to include in APS 210 a discretion to allow it to set an ADI's NSFR requirement above the minimum of 100 per cent. Similar to the approach for prudential capital requirements, APRA considers this discretion an important supervisory tool that will allow supervisors to increase an ADI's minimum required NSFR where APRA has concerns about an ADI's liquidity risk management, or is of the view that an ADI needs to improve its funding or liquidity risk profile. APRA would set the NSFR on a bilateral basis with the ADI.

4 Refer to footnote 3.

Chapter 3 — Liquid assets requirement for foreign ADIs

In the March discussion paper, APRA set out proposals for the future application of a liquid assets requirement for foreign ADIs and a proposal for an annual LOC assessment.

3.1 Liquid assets requirement

The proposed liquid assets requirement included two options, one being retention of the existing 40 per cent LCR or a new approach, termed FALAR, being a modified version of the MLH regime currently applied to smaller, less complex locally incorporated ADIs. APRA proposed that one of these two approaches would apply to all foreign ADIs.

Comments received

Submissions were evenly divided on which approach was preferred with those foreign ADIs with less complex Australian operations leaning towards FALAR and those with more complex operations preferring to retain the 40 per cent LCR. Some foreign ADIs indicated they would continue to report the LCR to their head office if the FALAR was adopted given the LCR is the recognised global liquidity metric. Importantly, issues raised in submissions including the treatment of derivatives, repos, netting arrangements and non-AUD liabilities under FALAR indicate that application of the FALAR would not necessarily be as straight-forward and may make it more difficult to implement than APRA intended. Submissions also indicated that FALAR was not necessarily ideal as a one-size-fits-all approach.

APRA's response

In the March discussion paper, APRA indicated its preference for FALAR given its simplicity, being fit-for-purpose and uniform but scalable. In light of the issues raised in submissions, APRA accepts that implementation of the FALAR would not be as straight-forward as intended.

While the 40 per cent LCR requirement for foreign ADIs was initially implemented as an interim measure it is clearly understood and well accepted by industry. Retention of the 40 per cent LCR requirement would involve no operational changes or changes to reporting requirements for foreign ADIs subject to the LCR.

APRA therefore proposes to maintain the existing 40 per cent LCR regime as the default liquid assets requirement for foreign ADIs. However, acknowledging differences in the nature and complexity of operations of foreign ADIs in Australia, APRA will, on application from a foreign ADI, consider designating a foreign ADI as an MLH ADI. This would mean the foreign ADI would operate under the MLH regime rather than the 40 per cent LCR requirement. APRA expects that it would only consider such applications from foreign ADIs with smaller, less complex operations in Australia.

3.2 Local operational capacity

The March discussion paper proposed that foreign ADIs be required to perform a LOC assessment, at least annually. The LOC assessment would consider a scenario in which a combination of time zones, different public holidays and an offshore operational risk event required a foreign ADI to operate, including making and receiving payments, for three business days without assistance from staff located outside Australia. It was noted that, for this purpose, a foreign ADI could assume that related-party operations in Australia, such as locally incorporated subsidiaries, are functioning normally.

Comments received

The majority of submissions commenting on the proposed LOC assessment were supportive of the proposal. Some submissions noted that the LOC assessment could overlap with requirements in prudential standards relating to risk management,

outsourcing and business continuity management and queried whether the LOC assessment would be better addressed in an operational standard.

APRA’s response

APRA proposes to proceed with implementation of the requirement for a foreign ADI to conduct an annual LOC assessment as detailed in the March discussion paper. On the issue of overlap with existing prudential requirements, the LOC assessment is a scenario designed to test the ability of a foreign ADI to access its liquid assets in order to effect payments. APRA considers it appropriate that this form part of the liquidity requirements for a foreign ADI as it is complementary to other requirements in APRA’s operational prudential standards.

Chapter 4 — Other changes to *Prudential Standard APS 210 Liquidity*

APRA is proposing to make a number of other changes to APS 210 and APG 210. Most of these changes are minor in nature; however, more material changes are noted below.

4.1 Prudential standard

4.1.1 Funding strategy

Under APS 210, ADIs are required to develop an annual funding strategy which is approved by the Board and reviewed on a regular basis. Similar to the requirement in *Prudential Standard CPS 220 Risk Management* regarding a rolling business plan of at least three years duration that is reviewed at least annually, APRA proposes to change the annual funding strategy to a three-year funding strategy that would also be reviewed at least annually. All other aspects of the funding strategy are unchanged. This change, in addition to the removal of the going concern analysis (refer to 4.1.2 below), will make the prudential framework more coherent and less burdensome for ADIs.

4.1.2 Going concern analysis

After reviewing the going concern requirements in APS 210, APRA is of the view that there is limited value in requiring ADIs to continue to perform such analysis as it is mostly duplicative of ADIs' funding strategies. This requirement can be unduly onerous for smaller ADIs and, in many respects, the funding strategy requirements in APS 210 capture the relevant aspects of such analysis. APRA therefore proposes to remove the requirement for an ADI to conduct a going concern analysis from APS 210, including removal of existing Attachment B.

4.1.3 LCR requirement

Under APS 210, a locally incorporated ADI is required to ensure the value of its LCR is at least 100 per cent. In practice, this requirement applies on both an AUD and all currencies basis. In order to provide consistency on this matter, APRA has made clear in the standard that the requirement is to be met on both an AUD and all currencies basis.

As per the existing requirement, for foreign ADIs, the 40 per cent LCR is an all currencies requirement.

4.1.4 Committed funding facility for foreign ADIs

Under APS 210, a foreign ADI may only recognise a head office committed funding facility as a cash inflow from Day 16 under its LCR. APRA proposes to modify this requirement such that a foreign ADI may meet up to 50 per cent of its LCR liquid assets requirement with a head office committed funding facility. The remainder of the liquid assets requirement would be met with eligible liquid assets as detailed in Attachment A of draft APS 210.

4.1.5 Previous exercise of discretion

APRA proposes to include a provision in the prudential standard that will require an ADI to contact APRA should the ADI intend to place reliance on a previous exemption or other exercise of discretion by APRA under a previous version of APS 210. APRA will assess whether an ADI is able to continue to place reliance on a previous exemption or exercise of discretion.

4.2 Prudential Practice Guide

APRA has made a number of editorial and other changes for clarity and presentational purposes, including to reflect proposed changes to APS 210, as well as incorporating guidance on the NSFR. All changes are marked in the draft revised APG 210 released with this response paper.

Chapter 5 — Request for cost benefit information

To improve the quality of regulation, the Australian Government requires all proposals to undergo a preliminary assessment to establish whether it is likely that there will be business compliance costs. The preliminary assessments for the proposals outlined in this discussion paper concluded that measurable compliance costs are likely and thus a formal Regulation Impact Statement (RIS) will be required. In order to perform this comprehensive cost-benefit analysis, APRA requests that all interested stakeholders use this consultation opportunity to provide information on the compliance impact of the proposed changes and any other substantive costs associated with the changes. Compliance costs are defined as direct costs to businesses of performing activities associated with complying with government regulation. Specifically, information is sought on any increases or decreases to the compliance costs incurred by businesses as a result of this proposal.

Consistent with the Government's approach, APRA will use the methodology behind the Regulatory Burden Measurement Tool to assess compliance costs. This tool is designed to capture the relevant costs in a structured way, including a separate assessment of upfront costs and ongoing costs. It is available at https://rbm.obpr.gov.au/home.aspx.

Respondents are requested to use this methodology to estimate costs to ensure that the data supplied to APRA can be aggregated and used in an industry-wide assessment. When submitting their cost assessment to APRA, respondents are asked to include any assumptions made and, where relevant, any limitations inherent in their assessment. Feedback should address the additional costs incurred as a result of complying with APRA's requirements or expectations, not activities that institutions would undertake regardless of regulatory requirements in their ordinary course of business.

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