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Post-implementation review of the Basel III liquidity ratios in Australia

The Australian Financial Markets Association (AFMA) welcomes the opportunity to make comment on current Liquidity Coverage Ratio (LCR) and Net Stable Funding Ratio (NSFR) liquidity measures under APS 210, (the Standard) particularly regarding the performance and usefulness of the LCR and whether there are any areas for improvement. These comments are our general assessment of these factors and are provided on the basis that our ADI members will be directly presenting their views to APRA.

Performance and usefulness of the LCR

As a core feature of the Basel III liquidity reforms, the application of the LCR enhances banks' short-term resilience, serving also to mitigate systemic risk during times of financial crisis and any accompanying idiosyncratic or systemic liquidity stress. In mandating that under the LCR, large banks are required to hold a prescribed amount of high-quality liquid assets (HQLA) sufficient to fund cash outflows for 30 days, regulators and central banks are provided a window in time in which to intervene, if need be, with corrective measures designed to stabilise the domestic financial systems.

The LCR will continue to be an important tool to protect financial systems globally. LCR does have costs in the Australian context associated with the optimisation of ADI's lending performance. Cash which otherwise would be on-lent to retail and commercial clients is employed in low yield HQLA1 which from the Australian regulatory perspective can only be (a) notes and coin and settlement funds (b) Commonwealth Government and semi-government securities and (c) debt securities guaranteed by the Australian Government.

This constraint affects 14 domestic ADIs (subject to both the LCR and NSFR) and an additional 42 foreign bank branches which are subject to the LCR.

Areas for Improvement

1. Recognition of a broader class of HQLA1 assets and HQLA2 assets

The current APS 210, while defining what constitutes HQLA1, does not recognise as eligible any Australian currency (AUD) debt security issued by what are widely referred to as Public Sector Entities (PSEs) or alternatively Supranational, Sovereign and Agency (SSA) Australian dollar denominated bonds, where such securities are assigned a zero per cent risk-weight. These securities are now widely traded in the Australian and global debt markets and may warrant APRA's consideration as eligible for inclusion in HQLA1. We note that these securities are eligible for RBA Repo.

Similarly, APS210, while defining what constitutes HQLA 2A and 2B assets, it does not recognise the existence of any assets as satisfying the liquidity criteria as described within the Standard, this notwithstanding that active deep and liquid markets exist in both debt securities issued by PSE's or SSA's and assigned a 20 per cent risk weight, and for certain ASX200 equities. AFMA contends that the former, ie PSE and SSA debt securities, are now widely traded in the Australian and global debt markets and should warrant APRA's consideration as eligible for inclusion in HQLA2A, while the latter ASX200 equities are similarly widely traded and may also warrant further consideration (excluding bank stocks) as eligible HQLA2B assets. It is acknowledged that an alternative methodology for monetisation of ASX200 securities would need to be developed as these are currently not eligible for repurchase agreement with the RBA.

2. Potential to only apply the LCR and NSFR to designated significant financial institutions

On 4th April 2022 APRA issued a consultation on minor amendments to centralise the definition of a significant financial institution (SFI) across a range of prudential standards. As proposed by APRA this definition will exclude all foreign ADIs, which suggests that the nature, scale and complexity of a foreign ADI generally reduces the systemic importance in the Australian context, particularly as foreign ADIs business activities and associated liquidity management are ultimately constrained by the LCR and NSFR requirements that apply in the head office jurisdiction. In authorising a foreign ADI to conduct business in Australia we believe that APRA will have taken this into account.

On this basis APRA may wish to consider also applying the definition to APS 210, recasting the applicability of the LCR and NSFR to SFIs only and potentially applying the minimum liquidity holdings approach (MLH) to foreign ADIs, while also assigning (from the current LCR requirement) appropriate recognition of access to head office funds via a documented committed funding facility provided by the head office to the foreign ADI to a maximum of 50% of the MLH requirement.

Reforms to enhance Australia's competitive position in global markets.

We contend that Australian competitive position in global markets, and particularly regarding our regional markets, would be enhanced by the adoption of the two above-referenced reforms without materially increasing idiosyncratic or systemic risk within Australia's financial system:

- The recognition of a broader class of HQLA will benefit both local and foreign ADIs, effectively lowering their cost base and so providing greater scope to improve lending margins. It will also place Australian ADIs on a similar footing as contemporaries in global markets and competitor jurisdictions.
- The application of the LCR and NSFR requirement to SFIs only and applying the minimum liquidity holdings approach (MLH) to foreign ADIs as suggested above may be a practical way to generate greater efficiency in foreign ADI operations, while also serving to significantly improve the risk-adjusted focus of APRA's oversight of LCR compliance monitoring, although with a commensurate increase in MLH compliance monitoring.

The above is not intended to be a comprehensive submission for consideration, instead representing views on relatively modest changes to the applicability of APS 210 and from which benefits will be extracted without materially increasing idiosyncratic or systemic risk within Australia's financial system.

For more information, or if you have questions in relation to this letter, please contact me at mregan@afma.com.au

Yours sincerely



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