15 November 2023

Moody's Investor Services

Submitted online: www.moodys.com

To whom it may concern,

Request for comment – Banks: Proposed Methodology Update

The Australian Financial Markets Association (**AFMA**) welcomes the opportunity to respond to Moody's Investor Services' (**Moody's**) Request for Comment, *Banks: Proposed Methodology Update* (**RFC**), released on 16 October 2023.

AFMA is supportive of Moody's proposal to update its Key Rating Assumptions (**KRAs**) to reflect an 'Operational Resolution Regime' (**ORR**) in Australia. However, AFMA recommends Moody's adopt a more nuanced approach to reflect that the Australian resolution framework is still being developed, the diversity of Authorised Deposit-Taking Institutions (**ADIs**) in Australia and that the local prudential regulator, the Australian Prudential Regulation Authority (**APRA**), is likely to adopt different approaches across this diverse population of ADIs.

As the leading Australian financial markets industry association, AFMA promotes efficiency, integrity and professionalism in Australia's financial markets, including the capital, credit, derivatives, foreign exchange, energy, carbon, and other specialist markets. As such, AFMA has a keen interest in Moody's KRAs regarding the Australian market and Australian ADIs.

AFMA's views reflect our more than 120 members, from Australian and international banks, leading brokers, securities companies and state government treasury corporations to fund managers, energy traders and industry service providers.

We note that a number of AFMA members have not been able to provide individual responses to the RFC given the short consultation period, which overlaps with other local consultations on related topics. As such, AFMA would welcome the opportunity to engage further with Moody's on this important topic and is able to provide further detail on the points raised in this letter. Initial observations based on member feedback received to date is included in Appendix A.

For more information or if you have questions in relation to this letter, please contact me on 0411 281 562 or at brendonh@afma.com.au.

Yours sincerely

Brendon Harper

Head of Banks and Prudential

Appendix A: Overarching industry observations

1. Ongoing development of an Operational Resolution Regime

As noted in the RFC, there have been “several legal and regulatory changes” to support an ORR in Australia. However, the institutional level detail of this framework is still being developed. Realistically, this level of detail, that would be required to operationalise resolution for ADIs in Australia, will take years to develop.

Reflecting this, and that APRA will apply its resolution regime differently to different ADIs, the relevant local Prudential Standard CPS 900 Resolution Planning (**CPS 900**) will not apply to all ADIs, when it comes into effect on 1 January 2024. Practically, it will be years before relevant ADIs are captured by CPS 900, with some ADIs unlikely to ever be subject to the standard’s requirements.

This is reflected in CPS 900 which states the scope of the standard as:

> “*This Prudential Standard requires significant financial institutions (SFIs), and non-SFIs that provide critical functions, to support resolution planning when notified by APRA.*”

In addition, APRA’s related prudential practice guide, CPG 900, paragraph 17, articulates that:

> *“…a small residential mortgage portfolio with a high degree of substitutability is unlikely to be considered a critical function.”*

CPG 900 provides further clarity, in paragraph 5, which states:

> “*The requirements in CPS 900 only become relevant to regulated entities when an entity is notified by APRA. Prior to this, there are no requirements under CPS 900 that entities need to meet. Entities are not required to prepare for CPS 900 implementation ahead of APRA’s notification.*”

This has been reinforced through correspondence with ADIs, including that:

> *“CPS 900 comes into force on 1 January 2024; however, individual institutions will only be subject to the requirements of CPS 900 when notified by APRA that it is commencing bespoke resolution planning for that institution. APRA is taking a risk-based and proportional approach by initially focussing on select Systemic Financial Institutions (SFI) for the implementation of CPS 900”.*

AFMA encourages Moody’s to reflect this staggered and divergent approach in its KRAs for Australia and would welcome the opportunity to work with Moody’s in developing such an approach.

2. Differing balance sheets and approaches

As currently drafted, the proposed approach does not adequately reflect the differences in balance sheets, across Australian ADIs. Particularly, the current approach does not accommodate the balance sheets of non-SFIs, including mutual banks.

AFMA recommends calibrating the proposed approach to reflect the large differences in balance sheet composition and associated risk profile (of SFIs vs non-SFIs/mutual banks) relative to the system average metrics used to inform the proposed ratings approach.

Particularly, the proposed Advanced Loss Given Failure (**LGF**) parameters do not adequately take into account the differences in non-SFIs/mutual banks (compared to SFIs), including:

a. Likely resolution approaches – in the unlikely event that APRA intervention is required, some ADIs, particularly smaller ADIs, would likely be 'resolved' via a bank transfer, rather than bailing in investors or via a 'good bank/bad bank' approach;
b. Loss Rates – (smaller) non-SFIs have significantly lower risk profiles, compared to system averages, with exposures skewed towards low risk residential mortgages;
c. Deposit run off rates – customer and deposit composition at (smaller) non-SFIs are not adequately reflected in the currently proposed approach which suggests run off rates greater than that indicated under APRA's liquidity framework;
d. Wholesale funding composition and footings – Australia, like many other jurisdictions, implemented support measures for financial markets and participants over recent years. These support measures, such as the Term Funding Facility, are being wound back or closed. This will result in a change in ADIs' funding composition over the coming years. This, and the differences in impact across ADIs, should be taken into account in Moody's approach; and
e. Levels and composition of capital – there is significant variance in the level and composition of capital across ADIs. Moody's methodology should be refined to take into account these variances and the likely impact on LGF.

As noted above, AFMA would welcome the opportunity to explore these recommendations and observations with Moody's in more detail before the proposed approach is finalised.