Basel Committee
on Banking Supervision

Regulatory Consistency Assessment Programme (RCAP)

Assessment of Basel III LCR regulations – Australia

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BANK FOR INTERNATIONAL SETTLEMENTS

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Contents

Glossary

ADI	Authorised deposit-taking institution
APG	ADI Prudential Practice Guide
APS	ADI Prudential Standard
ARS	ADI Reporting Standards
APRA	Australian Prudential Regulation Authority
Banking Act	Banking Act 1959
Basel Committee	Basel Committee on Banking Supervision
BIS	Bank for International Settlements
C	Compliant (grade)
D-SIB	Domestic systemically important bank
FAQ	Frequently asked question
FSAP	Financial Sector Assessment Program
G-SIB	Global systemically important bank
HLA	Higher loss absorbency
HQLA	High-quality liquid assets
LC	Largely compliant (grade)
LCR	Liquidity Coverage Ratio
MAS	Monetary Authority of Singapore
MNC	Materially non-compliant (grade)
NC	Non-compliant (grade)
PAIRS	Probability and Impact Rating System
PCR	Prudential capital requirement
PIE	Personal Investment Entity
PPGs	Prudential Practice Guides
QIS	Quantitative Impact Study
RBNZ	Reserve Bank of New Zealand
RCAP	Regulatory Consistency Assessment Programme
SIG	Supervision and Implementation Group
SMSF	Self-managed super fund
SOARS	Supervisory Oversight and Response System

Preface

The Basel Committee on Banking Supervision (Basel Committee) sets a high priority on the implementation of regulatory standards underpinning the Basel III framework. The prudential benefits from adopting Basel standards can only fully accrue if these are implemented appropriately and consistently by all member jurisdictions. The Basel Committee established the Regulatory Consistency Assessment Programme (RCAP) to monitor, assess and evaluate its members' implementation of the Basel III framework.

This report presents the findings of an RCAP Assessment Team on the domestic adoption of the Basel Liquidity Coverage Ratio (LCR) in Australia and its consistency with the minimum requirements of the Basel III framework. The assessment is based on the Australian LCR rules of the Authorised Deposit-taking Institutions (ADI) Prudential Standards (APS), supplemented by the ADI Reporting Standards (ARS) and ADI Prudential Practice Guide (APG).

The RCAP Assessment Team was led by Mr Ong Chong Tee, Deputy Managing Director of Monetary Authority of Singapore (MAS). The Assessment Team comprised two technical experts drawn from Turkey and the United States (Annex 1). The main counterparty for the assessment was the Australian Prudential Regulation Authority (APRA), which in turn coordinated with other Australian authorities. The overall work was coordinated by the Basel Committee Secretariat with support from MAS staff members.

The focus of the assessment was on the consistency and completeness of the Australian LCR rules with the Basel minimum requirements. Issues relating to prudential outcomes, the liquidity position of individual banks or the effectiveness of APRA's supervisory effectiveness were not in the scope of this RCAP assessment. The assessment relied upon data, information and materiality computations provided by APRA and was based on Australian regulations in force as of 30 June 2017. Where deviations from the Basel III framework were identified, they were evaluated for their current and potential impact on the reported LCR for a sample of internationally active banks in Australia. Some findings were evaluated on a qualitative basis in instances where appropriate quantitative data were not available. The overall assessment outcome was then based on the materiality of findings (in both quantitative and qualitative terms) and ultimately reflects the expert view of the Assessment Team. The Assessment Team followed the methodology and guidance provided in the RCAP Handbook for Jurisdictional Assessments.[1]

Starting in November 2016, the assessment comprised (i) completion of an RCAP questionnaire (a self-assessment) by the Australian authorities; (ii) an assessment phase (February to June 2017); and (iii) a post-assessment review phase (July–September 2017). The second phase included an evaluation of the self-assessment provided by the Australian authorities as well as an on-site visit assessment, which included discussions with APRA and representatives of Australian banks. These exchanges provided the Assessment Team with a deeper understanding of the implementation of the Basel LCR standards in Australia. The third phase consisted of a two-stage technical review of the assessment findings: first, by a separate RCAP Review Team (Annex 1) and via feedback from the Basel Committee's Supervision and Implementation Group (SIG); and second, by the RCAP Peer Review Board and the Basel Committee. This review process is a key part of the RCAP process, providing quality control and ensuring the integrity of the assessment findings.

The report has three sections and a set of annexes: (i) an executive summary with a statement from APRA; (ii) the context, scope and methodology and the main set of assessment findings; and (iii) details of the deviations and their materiality along with other assessment-related observations.

[1] See www.bis.org/bcbs/publ/d361.pdf.

The RCAP Assessment Team acknowledges the professional cooperation received from APRA throughout the assessment process. In particular, the Assessment Team sincerely thanks the APRA Chairman Wayne Byres and APRA member Kevin Stephenson and the staff of APRA for the professional and efficient cooperation extended to the team throughout the assessment.

The Assessment Team is confident that the RCAP assessment exercise will contribute towards further strengthening of the prudential effectiveness and full implementation of the LCR in Australia.

Executive summary

The Australian framework for LCR requirements was issued in November 2014 through the publication of the final Prudential Standard APS 210 Liquidity and the associated reporting framework. The requirements came into effect in January 2015. The Prudential Standard APS 210 Liquidity applies to all Authorised Deposit-taking Institutions (ADIs) in Australia, including small and medium-sized commercial banking institutions that are not internationally active, although it applies to the smallest domestic institutions with a degree of proportionality to take into account the size and nature of their activities.

Overall, as of 30 June 2017 (the cut-off date for the RCAP assessment), the LCR regulations in Australia are assessed as compliant with the Basel LCR standard. This is the highest of the four possible grades. The components of the LCR standard for liquidity outflows, liquidity inflows and the LCR disclosure requirements are assessed as compliant while the other component, high-quality liquid assets (HQLA), is assessed as largely compliant. The Assessment Team compliments APRA for their implementation of, and alignment with, the Basel LCR framework.

The HQLA component grade is driven mainly by one material finding relating to the inclusion of all securities eligible for market operations with the Reserve Bank of New Zealand (RBNZ) notwithstanding some of those securities would not meet the requirements of HQLA in the Basel LCR standard. As is the case in Australia, government securities in New Zealand denominated in domestic currency are relatively limited in supply and cannot meet the aggregate demand of ADIs with significant exposures in New Zealand dollars (NZD). While the Basel LCR standard allows for the use of alternative liquidity approaches (ALA) in jurisdictions where there is an insufficient supply of HQLA in their domestic currency, New Zealand has chosen to implement its own liquidity regime.[2] Although the RBNZ liquidity requirements introduced in August 2010 are different from the requirements of the Basel LCR standard, APRA deems this host supervisory liquidity regime to be acceptable and very similar in concept to the LCR standard. As such, locally incorporated ADIs with New Zealand subsidiary operations are permitted to include all securities that are eligible for market operations with the RBNZ in the numerator of the LCR These securities include not only NZ government securities RBNZ bills but also (subject to credit rating requirements and haircuts) securities issued by local authorities, residential mortgage- backed securities, corporate securities and asset-backed securities.[3]

Notwithstanding, the Assessment Team raised this issue, as well as another one relating to the application of the ALA in the context of the differences between the home and host liquidity requirements, as an area for further guidance from the Basel Committee. While the Basel LCR standard allows a cross-border banking group to adopt the relevant parameters in host jurisdictions for the treatment of its retail and small business deposits as well as to recognise some jurisdiction-specific factors, the application issue of cross-border banking groups operating in non-Basel member jurisdictions with an insufficient supply of HQLA and a different liquidity regime was not clearly specified.

In addition to the formal assessment of the LCR standard and disclosure requirements, this report contains annexes that summarise Australia's implementation of the LCR monitoring tools and the Basel Committee's *Principles for sound liquidity risk management and supervision* (see Annexes 8 and 9). Further, a summary is provided of the key national discretions and approaches that APRA has adopted in their implementation of the LCR standard (Annex 13). These annexes show how national authorities implement certain aspects of the Basel standards that are not in scope of the formal RCAP-LCR assessment. Over time, the information detailed in these annexes will provide a basis for designing best

2 The Reserve Bank of New Zealand, *Liquidity mismatch ratio*.

3 The full list of these securities is available at www.rbnz.govt.nz/-/media/ReserveBank/Files/regulation-and-supervision/banks/banking-supervision-handbook/3675953.pdf?la=en.

practices and additional supervisory guidance that will benefit the regulatory community and the banking industry to raise the consistency of LCR implementation and improve the ratio's effectiveness in practice.

Response from APRA

APRA wishes to acknowledge the open and professional manner with which the RCAP team conducted the assessment and express our sincere thanks to Mr Ong Chong Tee and the team. While time-consuming, the RCAP process provides a valuable opportunity to reflect on our implementation of the LCR, benchmark ourselves against our global peers and identify areas for improvement. Australia is committed to participating in and supporting future assessments.

We welcome the overall rating of "compliant" with the Basel LCR standards. As noted in the report, the vast majority of the Australian implementation of the LCR is aligned with the Basel standard. For a small number of issues, APRA has taken a pragmatic approach to a unique set of jurisdiction-specific circumstances not strictly contemplated by the Basel standard. However, at all times, our intent has been to align with the spirit of the Basel standard. We appreciate the effort made by the RCAP team to understand APRA's approach to these issues.

The implementation of the LCR has improved the liquidity risk management of our largest and most complex ADIs. APRA will continue to focus on the effective operation of the LCR through rigorous routine supervision to ensure a robust and consistent adoption by the industry.

1. Assessment context and main findings

1.1 Context

Status of implementation

In November 2014, APRA, the prudential regulator of the financial services sector in Australia, published the final Prudential Standard APS 210 Liquidity and the associated reporting framework that gave effect to major elements of the Basel III liquidity reforms in Australia. APS 210 provides for the introduction in Australia of the LCR, which came into force from 1 January 2015.[4]

Subsequently, in December 2016, APS 210 was updated to include the Net Stable Funding Ratio requirements along with some minor changes to LCR sections, typically to provide greater clarity to regulated entities as well as to add to the framework provisions for Level 2B high-quality liquid assets (HQLA). These changes will come into force from 1 January 2018.

Prudential Standards apply to all ADIs in Australia, including small and medium-sized commercial banking institutions that are not internationally active, although it applies to the smallest domestic institutions with proportionality to take into account the size and nature of their activities. Foreign ADIs (ie foreign bank branches), while subject to APS 210, are primarily subject to LCR regulations of their home jurisdiction.

Structure of the banking sector

In December 2016, there were 151 ADIs in Australia with total assets (excluding off-balance sheet assets) amounting to approximately AUD 4.6 trillion (see also Annex 6). This corresponds to approximately 276% of the gross domestic product. The banking system is highly concentrated. There are 15 designated LCR ADIs which hold approximately 90% of total banking assets – furthermore, five ADIs hold over 90% of the banking assets of this subset of ADIs.

No Australian banks are classified as global systemically important (ie none have been identified as a G-SIB); the four largest ADIs have been classified as domestic systemically important banks (D-SIBs).

Regulatory system and model of supervision

Australia has a functional model of financial supervision in which the prudential oversight of all ADIs, insurers and large superannuation funds rests with APRA. The Australian Securities and Investments Commission (ASIC) is responsible for market and corporate conduct, including consumer protection. The Reserve Bank of Australia has responsibility for overseeing financial system stability and the payments system. Coordination takes place through the Council of Financial Regulators (CFR).

APRA was established under the *Australian Prudential Regulation Authority Act 1998* on 1 July 1998 and is responsible for authorising and supervising ADIs. APRA is solely responsible for implementing Basel III in Australia. It derives its legal authority to formulate and amend Prudential Standards from the *Banking Act (1959)* (Banking Act).

[4] APRA's Prudential and Reporting Standards are available online on APRA's external website at: www.apra.gov.au/adi/PrudentialFramework/Pages/prudential-standards-and-guidance-notes-for-adis.aspx and www.apra.gov.au/adi/ReportingFramework/Pages/ADI-Reporting.aspx.

1.2 Structure, enforceability and binding nature of prudential regulations

Structure of prudential regulations

The relevant hierarchy of prudential regulations through which APRA implemented the Basel Framework in Australia consists of the following levels:

(i) Prudential Standards made under the Banking Act;

(ii) Reporting Standards made under the *Financial Sector (Collection of Data) Act 2001* (FSCODA);

(iii) Prudential Practice Guides (PPGs) and other guidance;[5] and

(iv) Letters to industry.

Prudential Standards and Reporting Standards are legislative instruments and have the force of law. The Prudential Standards are supplemented by PPGs, other guidance and letters to industry that provide non-enforceable, non-binding guidance on certain prudential matters. Non-adherence to guidance is not a formal breach of the Prudential Standards. Notwithstanding, depending upon the nature and extent of non-adherence, supervisors may take this into account through APRA's Probability and Impact Ratings System (PAIRS) and Supervisory Oversight and Response System (SOARS) supervisory tools in determining an appropriate response, which may include an increase in the regulatory capital requirement or revocation of approval to use a particular methodology.

The internal supervisory processes and procedures under the supervision framework through which APRA supervises the compliance of ADIs with standards, PPGs and letters, include PAIRS and SOARS.[6]

Enforceability and binding nature of prudential regulations

As a general principle, RCAP assessments only take into consideration "binding" regulatory documents that implement the Basel III framework. This is to ensure that the Basel requirements are set out in a robust manner and that a formal basis exists for supervisors and third parties to ensure compliance with the minimum requirements.

The Assessment Team examined the binding nature of various prudential documents issued by APRA using the criteria being applied in RCAP assessments (see Annex 5). Based on the assessment of these seven criteria, the Assessment Team concluded that the Prudential and Reporting Standards, which are legally binding, as well as the PPGs issued by APRA, which give further clarification to the Standards, meet the criteria and hence are eligible for the RCAP assessment. During meetings between the Assessment Team and ADIs, it was evident that PPGs are considered by all market participants to be as fully applicable as Prudential Standards. On that basis, the Assessment Team concluded that PPGs can be considered within the context of the RCAP assessment.

1.3 Scope of the assessment

Assessment grading and methodology

As per the RCAP methodology approved by the Basel Committee, the outcome of the assessment was summarised using a four-grade scale: compliant, largely compliant, materially non-compliant and non-

5 Copies of APRA's PPGs and other guidance are available at: www.apra.gov.au/adi/PrudentialFramework/Pages/authorised-deposit-taking-institutions-ppgs.aspx.

6 Information about APRA's supervisory framework is available at: www.apra.gov.au/AboutAPRA/FOI/Pages/Information-Publication-Scheme.aspx.

compliant. The assessment was made at the level of the four key components of the Basel LCR framework (HQLA, outflows, inflows and LCR disclosure requirements) and at the overall level.[7]

The materiality of the deviations was assessed in terms of their current or, where applicable, potential future impact (or non-impact) on the banks' LCRs. Wherever relevant and feasible, the Assessment Team, together with APRA, attempted to quantify the impact based on data collected from Australian banks in the agreed sample of banks. The non-quantifiable aspects of identified deviations were discussed and reviewed with APRA, in the context of the prevailing regulatory practices and processes.

Ultimately, the assignment of the assessment grades was guided by the collective expert judgment of the Assessment Team. In doing so, the Assessment Team relied on the general principle that the burden of proof rests with the assessed jurisdiction to show that a finding is not material or not potentially material. A summary of the materiality analysis is given in Section 2 and Annex 7.

In two cases, Australia's LCR requirements go beyond the minimum Basel standards (see Annex 12). Although this provides for a more rigorous implementation of the Basel framework in this aspect, it has not been taken into account for the assessment of compliance under the RCAP methodology as per the agreed assessment methodology.

1.4 Main findings

Overall, the Assessment Team assesses the LCR regulations issued by the APRA to be compliant with the Basel standard. The components other than high-quality liquid assets are assessed by the RCAP Assessment Team (the LCR regulation and the LCR disclosure standards) as compliant whereas high-quality liquid assets are assessed as largely compliant with the minimum Basel standard. More detail is provided in the main findings section below.

Summary assessment grading Table 1

Key components of the Basel III LCR framework	Grade
Overall grade	Compliant
High-quality liquid assets (numerator)	Largely compliant
Outflows (denominator)	Compliant
Inflows (denominator)	Compliant
LCR disclosure requirements	Compliant

Definition of the grades: **compliant (C)**: all minimum Basel provisions have been satisfied and no material deviations have been found that would give rise to prudential concerns or provide a competitive advantage to internationally active banks; **largely compliant (LC)**: only minor provisions have not been satisfied and differences that have a limited impact on financial stability or the international level playing field have been identified; **materially non-compliant (MNC)**: key provisions of the framework have not been satisfied or differences that could materially impact the LCR: **non-compliant (NC)**: the regulation has not been adopted or differences that could severely impact the LCR and financial stability or international level playing field have been identified.

Colour code:

Compliant	C
Largely compliant	LC
Materially non-compliant	MNC
Non-compliant	NC

[7] This four-grade scale is consistent with the approach used for assessing countries' compliance with the Basel Committee's *Core principles for effective banking supervision*. The actual definition of the four grades has been adjusted to take into account the different nature of the two exercises. In addition, components of the Basel framework that are not relevant to an individual jurisdiction may be assessed as not applicable. For further details, see www.bis.org/bcbs/publ/d361.htm.

Main findings by component

General comments – Scope of application and transitional arrangements

The principles regarding the scope of application and transitional arrangements under the Australian LCR standard are consistent with the Basel requirement. The Assessment Team noted one non-material deviation. The team also identified one interpretative issue.

Regarding the non-material deviation, the Assessment Team noted that APRA requires banks to report the LCR on a quarterly basis instead of monthly, as required by the Basel LCR standard.

Further, the team identified one interpretative issue. The Basel standard specifies that when calculating the LCR on a consolidated basis, a cross-border banking group should apply the liquidity parameters adopted in the home jurisdiction to all legal entities being consolidated except for the treatment of retail and small business deposits. However, APRA allows for the cross-border banking group to also adopt the ALA parameters set by the host supervisors. The Assessment Team understands the rationale for APRA to adopt such an approach. While the ALA approach is clearly specified in the LCR standard, the application issue for the ALA in the context of the differences between the home and host liquidity requirements is not clearly addressed in the Basel LCR standard. In this regard, the Assessment Team raised this issue as an area for further guidance from the Basel Committee.

High-quality liquid assets (numerator)

The implementation of the HQLA requirements of the Basel LCR standard is assessed as largely compliant. The Assessment Team identified three findings, one of which is found to be material.

The first finding relates to the inclusion in HQLA of all securities eligible for market operations with the Reserve Bank of New Zealand (RBNZ), notwithstanding some of those securities would not meet the requirements for HQLA in the Basel LCR standard. The Assessment Team viewed this finding as material given that the inclusion of these assets (other than NZ government securities and RBNZ bills) overstates ADIs' LCRs by an average of 4.3%. The second finding relates to the absence, in Australian regulations, of the requirement that banks should periodically monetise a sample of HQLA in order to test access to the market and mitigate the risk of negative signalling during a period of actual stress. The Assessment Team viewed this finding as not material given that the majority of HQLA are denominated in Australian dollars (AUD) and frequently repo-ed with the RBA. The third and last finding relates to the absence, in Australian regulations, of the requirement that banks should have a policy in place that identifies legal entities, geographic locations, currencies, and specific custodian or bank accounts where HQLA are held. The Assessment Team also viewed this finding as not material given that the Australian authorities supervise ADIs in a manner consistent with the requirements of the Basel standard.

Outflows (denominator)

The Australian standard regarding liquidity outflows are assessed as compliant with the Basel standard. However, the Assessment Team identified six non-material findings.

The Assessment Team highlighted one peculiarity with regard to the implementation of LCR standard in Australia concerning the look-through treatment of intermediated deposits, eg personal investment entities (PIE)[8] and self-managed super funds (SMSF)[9]. Specifically, APRA allows these intermediated deposits to be treated as less stable retail deposits if they meet the strict look-through criteria imposed by APRA. For these types of deposit, less stable retail run-off rates (10% or 25%) can be

[8] A PIE is an investment entity that would be operated and controlled by individuals within the same family, solely for the personal benefit of those same family members, with the trustee and/or manager also being a beneficiary.

[9] An SMSF depositor is considered to be a self-selected, financially sophisticated individual who is undertaking an asset allocation investment choice.

applied by the banks. Given the stickiness of such deposits and the stringent look-through criteria imposed by APRA before the ADIs could apply such preferential run-off rates, the Assessment Team opined that such an approach is aligned in substance with the intent of the Basel LCR standard. However, the Assessment Team acknowledged that, in form, this is still a deviation.

Inflows (denominator)

The Australian standards regarding the liquidity inflows are assessed as compliant with the Basel standard. The Assessment Team noted only one non-material deviation. Specifically, the Basel III framework grants national discretion to jurisdictions to determine specific inflow rates to be applied to "other contractual inflows" bucket with specific explanations given to what comprises this bucket. APRA allows 100% inflow rate to be applied to other contractual inflows without specific explanations as required by Basel LCR standard.

Disclosure requirements

The Australia rules regarding the LCR disclosure requirements are assessed as compliant with the Basel standards. No deviations or observations were identified.

2. Detailed assessment findings

The component-by-component details of the assessment of compliance with the LCR standards of the Basel framework are detailed below. The focus of Sections 2.1 to 2.3 is on findings that were assessed to be deviations from the Basel minimum standards and their materiality. Section 2.4 lists some observations and other findings specific to the implementation practices in Australia.

2.1 Scope of application and transitional arrangements

Summary	Overall, the Assessment Team finds the Australian LCR standard to be consistent with the Basel requirement. One non-material finding was identified.
Basel paragraph number	162: reporting time lag
Reference in domestic regulation	ARS 210 paragraph 11
Findings	Basel framework requires LCR to be reported to supervisors at least monthly, with the operational capacity to increase the frequency to weekly or even daily in stressed situations at the discretion of the supervisor and the time lag in reporting be as short as feasible and ideally not to exceed two weeks. The Australian reporting standard requires an LCR ADI to provide the information required by APRA's Reporting Standard within 28 calendar days in respect of each quarter based on the financial year of the ADI. As explained by APRA, in order to conform with the majority of reporting forms, the frequency of LCR reporting was kept as quarterly instead of monthly.
Materiality	Not material While APRA's implementation requires a lower reporting frequency and a longer time lag compared to Basel standard, the Assessment Team noted that APRA requires ADIs to report the lowest LCR during the reporting period in addition to the LCR as at the end of the reporting period. This prevents ADIs from window-dressing the quarterly numbers. In addition, APRA stated that they are in the midst of updating their reporting to capture average daily LCR during the reporting cycle as well. Moreover, the Assessment Team understands that the key ADIs already have the capability to compute LCR on a daily basis. In addition, APRA has confirmed that: – it has the power to increase reporting frequency, when deemed opportune; – banks under its supervision are obliged to immediately report to their supervisor if the LCR falls below the minimum;[10] and – it has indicated that it is not aware of any circumstances where a bank's LCR has fallen below the regulatory minimum. In the light of the above, the Assessment Team concluded that this finding is not material.

[10] In accordance with Prudential Standard APS 210 "Liquidity" (APS 210), paragraph 11, an ADI must inform APRA as soon as possible of any concerns it has about its current or future liquidity, and its plans to address these concerns. In particular, if an ADI experiences a severe liquidity stress, it must notify APRA immediately. In addition, according to paragraph 5 of Attachment A, an ADI must inform APRA immediately in the event of an actual breach of its LCR requirement or if it becomes aware of circumstances that may result in a breach of its LCR requirement.

2.2 LCR

2.2.1 High-quality liquid assets (numerator)

Section grade	Largely compliant
Summary	The Assessment Team identified one material finding relating to the inclusion of all securities eligible for market operations with the Reserve Bank of New Zealand (RBNZ), notwithstanding some of those securities would not meet the requirements for HQLA in the Basel LCR standard. Two non-material findings were also noted, relating to the periodic monetisation of a sample of HQLA and the requirement that a bank have a policy in place that identifies legal entities, geographic locations, currencies, and specific custodian or bank accounts where HQLA are held.
Basel paragraph number	30: periodic monetisation
Reference in domestic regulation	APS 210 (November 2014) Attachment A paragraph 21
Findings	The Basel standard requires banks periodically monetise a sample of HQLA in order to test access to the market and mitigate the risk of negative signalling during a period of actual stress. The Australian regulation does not include this condition. The reason given by the Australian authorities is that ADIs routinely conduct repurchase agreements with the RBA to facilitate out-of-hours and intraday payments. However, repurchase agreements with the RBA are limited to AUD-denominated HQLA and do not account for the periodic monetisation of foreign currency-denominated HQLA.
Materiality	Not material Australian government securities and central bank balances constitute 78–100% of each ADI's HQLA. Australian government securities are regularly monetised with the RBA as part of monetary policy and payment system operations. Of the non-AUD-denominated and foreign central bank balance HQLA, approximately 77–100% comprises 0% risk-weighted securities issued by a foreign sovereign which can be repo-ed with foreign central banks. Furthermore, ADIs routinely test their ability to borrow against HQLA with foreign central banks. Consequently, for these assets, the practical consequences of omitting this requirement are limited. Based on these considerations, the Assessment Team views this finding as not material.
Basel paragraph number	35: identification of HQLA
Reference in domestic regulation	APS 210 (November 2014) paragraph 35
Findings	The Basel standard requires banks to have a policy in place that identifies legal entities, geographic locations, currencies, and specific custodian or bank accounts where HQLA are held. The Australian regulation does not include this condition. The reason given by the Australian authorities is that Australia's implementation of the Basel Sound Principles demonstrates intention to align with the Basel standard. However, the Basel Standard requirements for HQLA policies and procedures are separate and distinct from the broader collateral expectations in the Sound Principles.
Materiality	Not material According to APRA, ADIs are supervised in a manner consistent with the requirements of the Basel standard. Australian supervisors routinely examine whether ADIs have proper policies and procedures in place to ensure the appropriate identification of HQLA by legal entity, geographic location, currency, and other factors relevant to monetising HQLA. The Assessment Team believes that, given this supervisory approach, this finding does not rise to a materiality that would impact financial stability or the international level playing field.
Basel paragraph number	49–54: RBNZ eligible securities
Reference in domestic regulation	ARS 210 (March 2017) Section A: HQLA 5: RBNZ eligible securities

Findings	The Basel standard limits the numerator of the LCR to the stock of HQLA. In order to qualify as HQLA, assets should be liquid in markets during a time of stress and, ideally, be central bank-eligible. The Basel standard includes additional characteristics for HQLA as well as specific requirements for Level 1 and Level 2 HQLA. Australian regulation allows locally incorporated ADIs with New Zealand subsidiary operations to include all securities eligible for market operations with the Reserve Bank of New Zealand (RBNZ), notwithstanding some of those assets would not meet the requirements for Level 1 or Level 2 HQLA in the Basel LCR standards. These securities include not only NZ government securities and RBNZ bills, but also (subject to credit rating requirements and haircuts) securities issued by local authorities, residential mortgage-backed securities, corporate securities and asset-backed securities.[11] APRA indicated that the New Zealand market is similar to the Australian market in that the outstanding issuance of high-quality government securities is not sufficient to meet local HQLA needs of banks. Given this shortage of government securities and since New Zealand is not a member of the Basel committee, APRA recognised the NZ supervisory liquidity regime, which allows a broader range of securities eligible as HQLA than is allowed under the Basel LCR, as acceptable and determined that it would accept all RBNZ-eligible assets for the New Zealand subsidiaries of Australian banks. While NZ government securities and Reserve Bank of NZ bills are undoubtedly HQLA (under the Basel LCR rules), the liquidity of other assets, and subsequently their eligibility as Basel HQLA, is uncertain and neither APRA nor the Assessment Team has sought to determine whether these assets have sufficient liquidity (this is out of the scope of the assessment as NZ is not a BCBS member). Therefore, the materiality of the deviation has been assessed by excluding these other assets from the calculation of the Australian banks' Basel LCR (ie by including only NZ government securities and Reserve Bank of NZ bills).
Materiality	Material The Assessment Team considered this deviation as material. In practice, all securities eligible for market operations with the RBNZ can be included as part of the numerator of the LCR calculation, notwithstanding some of those assets would not meet the conditions of the Basel LCR standard. The inclusion of such assets materially overstates the ADI's HQLA and LCR ratios. Securities eligible for the RBNZ market operations other than NZ government securities and Reserve Bank of NZ bills, which are undoubtedly HQLA under the Basel LCR standard, comprise approximately 0–4.8% of each sample ADI's stock of HQLA. The inclusion of these assets overstates ADIs LCR by approximately 0–6.6%, or 4.3% on average. However, it should be noted that NZD net cash outflows comprise 0–15% of each sample ADI's total net cash outflows, or 7.6% on average. Furthermore, the ADI with the largest NZD net cash outflows does not hold total NZD HQLA (NZ government securities, Reserve Bank of NZ bills and other RBNZ eligible securities) in excess of total NZD net cash outflows. While, the remaining ADIs hold NZD total NZD HQLA in excess of NZD net cash outflows, this excess represents only 1–2% of the total all currency HQLA at these ADIs. In addition, APRA has closely monitored the proportion of total NZD HQLA that is recognised in the all-currency LCR. Where cases have been identified where the amount of total NZD HQLA was significantly higher than NZD-net cash outflows, APRA has taken steps to ensure the amount recognised is consistent with peers and reflects the availability of the HQLA in a stressed liquidity scenario (ie recognises regulatory and legal restrictions on the transfer of funds across borders). Therefore, the Assessment Team weighed the impact of New Zealand-related activities to the overall group activities of ADIs when considering the materiality of this finding and its impact on the HQLA section grade. The Assessment Team recognises that New Zealand has an insufficient supply of Level 1 HQLA assets in the domestic currency and has adopted a supervisory liquidity regime that is different from the Basel LCR standard. In turn, the Basel LCR standard

[11] The full list of these securities is available at www.rbnz.govt.nz/-/media/ReserveBank/Files/regulation-and-supervision/banks/banking-supervision-handbook/3675953.pdf?la=en.

	did not contemplate the interactions between jurisdictions that have implemented the Basel LCR standard and those that have not and may also have an insufficient amount of Level 1 HQLA in the domestic currency. Therefore, the Australian authorities cannot directly implement an ALA approach in the New Zealand jurisdiction to remedy the HQLA shortfall in the New Zealand domestic market. The Assessment Team hence raises this issue as an area for further guidance from the Basel Committee.

2.2.2 Outflows (denominator)

Section grade	Compliant
Summary	The Assessment Team identified six findings, all of which were found to be non-material: (i) treatment of retail deposits as deposits placed with a bank by a natural person; (ii) the use of supervisory approval to allow operational deposit run-off rates of 25%; (iii) treatment of deposits in institutional networks of cooperative banks and supervisory approval; (iv) liquidity needs related to the potential for valuation changes on posted collateral; (v) lending commitments, such as direct import or export financing for non-financial corporate firms run-off rates for other contingent funding obligations; and (vi) run-off rates for other contingent funding obligations.
Basel paragraph number	73: intermediated deposits
Reference in domestic regulation	APS 210 (November 2014) Attachment A paragraph 33, APG 210 (December 2016 paragraphs 113–114, APS 210 (December 2016) Attachment A paragraph 35
Findings	Basel describes retail deposits as deposits placed with a bank by a natural person. Deposits from legal entities, sole proprietorships or partnerships are captured in wholesale deposit categories. APRA allows various forms of intermediated deposits, including those from a personal investment entity (PIE) and a self-managed super fund (SMSF), to be treated as retail deposits if the intermediated deposits fulfil certain conditions. PIE is explained as an investment entity that would be operated and controlled by individuals within the same family, solely for the personal benefit of those same family members, with the trustee and/or manager also being a beneficiary. On the other hand an SMSF depositor is considered to be a self-selected, financially sophisticated individual who is undertaking an asset allocation investment choice. APRA's standard explicitly states that this activity is not consistent with the description of typical activity under a transaction account and classifies it as less stable. APRA described intermediated deposits as a company which is offering to place deposits with a specific bank on behalf of its customers. While the account is in the name of the intermediary, the movement of deposits into or out of the fund (and thus with the deposit holding bank) is based purely on the individual retail customers' decisions to put their money on deposit or to withdraw. The intermediary cannot make this decision and, as such, is purely a pass-through. The Assessment Team also noted that, although APS 210 version 2014 requires an ADI to notify APRA prior to applying a retail deposit treatment to a category of intermediated deposits in the LCR, this requirement was abandoned with the updated version of APS 210. APRA explained that, due to its significant administrative burden, it has moved to self-assessments that are examined in the course of normal supervision.
Materiality	Not material The Assessment Team noted APRA's explanation that the Australian financial system has substantial dependency on defined contribution pension funds and intermediary deposits. It might be regarded as an Australia-specific implementation issue. It has been observed by the team that APRA explicitly stated the conditions in order to utilise less stable deposit run-off rates for SMSF and PIE deposits through APS 210. If a deposit from these structures fails to meet the conditions stated in the standard, then the ADI is required to apply the higher wholesale cash outflow rate for those deposits. Under this structure, the fund manager has no legal right to withdrawal or other movement of the funds, and the natural owner of the deposit exercises these rights and cannot transfer his/her rights to the intermediary. Last but not least the

	intermediary or an associated entity can neither make investment decisions on behalf of the person regarding the deposit, nor withdraw funds from the ADI in the absence of specific directions from the natural person. APRA has also indicated that there are specific regulatory constraints that give deposits via PIEs and SMSFs similar characteristics to direct deposits. This includes strict limitations on the number and composition of beneficiaries and requirements regarding the discretion to move funds. SMSFs are used for retirement funds only and SMSF annual contributions are limited annually by law, thus limiting potential inflows when compared to ordinary retail deposits. PIEs are typically created for tax, family planning or liability limitation reasons. In addition, deposits from SMSFs are automatically considered a "less stable" retail deposit under APRA's implementation of the LCR, which means they receive an outflow rate of at least 10%, and as high as 25% based on a "scorecard" approach which assesses characteristics consistent with the Basel guidance (ie deposit size, propensity to withdraw based on access method and price sensitivity). As such, less stable deposits are accorded a higher outflow factor where appropriate. Given the above, the Assessment Team is of the view that these deposits are close to equivalent in nature to those that are placed directly by the natural person. From this perspective, the Assessment Team concluded that this finding is not material.
Basel paragraph number	93: operational deposits
Reference in domestic regulation	APS 210 (November 2014 & December 2016) Attachment A paragraph 47
Findings	The Basel LCR framework requires that supervisory approval would be required to ensure that banks utilising the operational deposit treatment with a 25% run-off rate conduct the relevant operational activities at the level indicated. Although the Australian LCR framework provides a definition on operational deposits which is similar to that of the Basel LCR framework, it does not include supervisory approval requirements.
Materiality	Not material APRA explained that, through supervisory activities, they have reviewed operational deposit definitions and provided feedback to ADIs to ensure compliance with APS 210 and consistency across the industry. APRA also has the supervisory powers to review operational deposit classifications and methodologies of ADIs and, if it deems it necessary, to request an ADI to revise its classification and recognise operational deposits as excess deposits. The Assessment Team viewed this finding as not material.
Basel paragraph number	105 and 106: cooperative banks
Reference in domestic regulation	ARS 210 (November 2014) Section B Item 2.6, APS 210 (November 2014) Attachment A paragraph 64 (No reference for Basel III LCR paragraph 106)
Findings	Paragraph 105 of the Basel framework sets out the conditions where a 25% run-off rate can be applied to deposits of member institutions in networks of cooperative banks with the central institution or specialised central service providers. Paragraph 106 of the same framework stipulates that supervisory approval would have to be given before the utilisation of this treatment. APRA's rules do not set out the cash outflow rates for such deposits and also do not require supervisory approval.
Materiality	Not material APRA explained that there are no institutional networks of cooperative banks in Australia and none of the subsidiaries of its ADIs are part of such kind of structure abroad. Further, APRA explained that they have adopted the text from the Basel rules to be prepared for any potential changes to the regulatory framework in the future and for ADIs that operate in jurisdictions that may have this legal structure which enables it to use the relevant run-off rates. APRA stated that, given the small number of LCR ADIs, the authority is able to monitor the situation and provide clarifications to the ADIs whenever necessary. In the light of the information received, the Assessment Team deemed that the lack of cash outflow rates and supervisory approval are not material.

Basel paragraph number	119: collateral posted
Reference in domestic regulation	APS 210 (November 2014) Attachment A paragraph 53, ARS 210 (November 2014) Section B Item 6.7
Findings	The Basel LCR framework states that, where counterparties are securing marked-to-market exposures with collateral other than Level 1 assets, 20% of the value of all such posted collateral, net of collateral received on a counterparty basis must be added to the stock of required HQLA by the bank posting such collateral so as to cover the potential loss of market value of these securities. This 20% must be calculated based on the notional amount required to be posted as collateral after any other haircuts have been applied that may be applicable to the collateral category. APRA's rules require ADIs to calculate this 20% using market value, rather than the notional amount.
Materiality	Not material It was observed that none of the ADIs have engaged in these activities at the time of the assessment, and this is not likely to change in the next few years.
Basel paragraph number	139: lending commitments
Reference in domestic regulation	APG 210 (December 2016) paragraph 141
Findings	Basel requires lending commitments are to be excluded from utilising the lower run-off rate allowed for contingent funding obligations stemming from trade finance instruments. Banks are required to apply the draw-down rates specified in paragraph 131 instead. APRA's rules states that lending commitments for non-financial corporate firms can be excluded from utilising the run-off rate for letter of credit and other trade finance instruments. The usage of "can be excluded" instead of "are excluded" allows ADIs to utilise the run-off rate for letter of credit and other trade finance instruments for their lending commitments for non-financial corporate firms.
Materiality	Not material APRA explained that, while the language used may sound more tentative than that used in the Basel LCR standard, the intent of the regulation is the same. The Assessment Team also noted APRA's representation that ADIs do not utilise the run-off rate for letter of credit and other trade finance instruments for their lending commitments for non-financial corporate firms.
Basel paragraph number	140: contingent obligations
Reference in domestic regulation	APS 210 (November 2014) Attachment A paragraph 53, ARS 210 (November 2014) Section B Item 9.8
Findings	The Basel LCR framework requires that a minimum 50% run-off factor of the contingent obligations be applied where banks have internally matched client assets against other clients' short positions where the collateral does not qualify as Level 1 or Level 2, and the bank may be obligated to find additional sources of funding for these positions in the event of client withdrawals. APRA's rules do not prescribe a run-off factor for this category, but instead state that the run-off rate is to be set by APRA for each ADI after consultation with the ADI. APRA's rules do not explicitly state that the run-off rate will be at least 50%.
Materiality	Not material It was observed that the ADIs have not engaged in activities where customer short positions are covered by other customers' collateral that does not qualify as HQLA at the time of the assessment, and this is not likely to change in the next few years. The Assessment Team believes that if ADIs were to begin engaging such activities APRA has the capacity to ensure that the minimum run-off rate for these transactions should not be less than 50%. Thus, this issue is not considered material.

2.2.3 Inflows (denominator)

Section grade	Compliant
Summary	The Assessment Team identified one non-material deviation relating to the treatment of "other contractual cash inflows".
Basel paragraph number	160: other contractual cash flows
Reference in domestic regulation	APS 210 (November 2014 & December 2016) Attachment A paragraph 66
Findings	The Basel LCR framework requires that all other contractual cash inflows to be captured under the "other contractual cash inflows" bucket, along with an explanation on what comprises this bucket and inflow percentages are to be determined as appropriate for each type of inflow by supervisors in each jurisdiction. In APRA's prudential standard APS 210 issued in November 2014, which is currently in force, it similarly requires all other contractual cash inflows to be captured under the "other contractual cash inflows" bucket, along with an explanation on what comprises this bucket. However, the Assessment Team noted that APRA's reporting standard ARS210 does not set out any reporting requirements for the explanation on what comprises this bucket. Also, rather than determining the inflow percentages for each type of inflow as appropriate, the rules stipulate the application of 100% inflow rate for all types of inflow in this bucket. In addition, in the revised APS 210 issued in December 2016 which will be in effect from 1 January 2018, the requirement for an explanation on what comprises the "other contractual cash inflows" bucket was removed, and all types of inflow in this bucket will continue to receive the 100% inflow rate.
Materiality	Not material During the on-site visit the Assessment Team noted that APRA has the power to request ADIs to specify what items are included in this category whenever required. APRA also informed the Assessment Team that they supervise these issues closely and they have the tools and capability to receive information to analyse banks' inflows and can request further details if needed. One such example is given by APRA's monitoring of changes in net cash outflow composition as a result of the annual Committed Liquidity Facility (CLF) assessment for locally incorporated banks as well as regular analysis of the routine regulatory returns. The Assessment Team notes that such activities would allow the authority to identify contractual inflows that they consider not eligible for the 100% inflow factor. APRA has also confirmed that, to date, the vast majority of ADIs have been reporting zero or immaterial amounts for this item (for the one ADI that reports a material amount, APRA has queried the item and is comfortable with the composition). This deviation is therefore assessed as not material.

2.3 LCR disclosure requirements

Section grade	Compliant
Summary	The Assessment Team did not identify any findings.

2.4 Observations and other findings specific to the implementation practices in Australia

2.4.1 Scope of application and transitional arrangements

Basel paragraph number	169: host ALA
Reference in domestic regulation	APS 210 (November 2014) Attachment A paragraph 26
Observation	The Basel framework requires that relevant parameters adopted in host jurisdictions be followed for the treatment of retail and small business deposits to enable the stressed liquidity needs of legal entities of the group. APRA transposed this treatment. In addition, APRA has another exception which is not related to parameters adopted in host jurisdictions for particularly retail and SME deposits. APRA states that, if the host country allows alternative liquid assets as provided for in the Basel LCR standard, then this amount can be included in the consolidated LCR calculation. This issue is to be brought to the Basel Committee's attention for further guidance.

2.4.2 Outflows (denominator)

Basel paragraph number	118: collateral in case of a downgrade
Reference in domestic regulation	APS 210 (November 2014 & December 2016) Attachment A Table 3, APG 210 paragraph 136
Observation	The Basel framework that for each contract in which "downgrade triggers" exist, the bank assumes that 100% of this additional collateral or cash outflow will have to be posted for any downgrade up to and including a 3-notch downgrade of the bank's long-term credit rating. Both APS 210 Liquidity and APG 210 Liquidity cover Basel's requirement. However, there is a slight discrepancy between those standards. APS 210 requires ADIs to account for a three-notch downgrade while APG 210 requires ADIs to account for up to and including a three-notch downgrade. APRA explained that the three-notch downgrade generates the most severe outflow profile and is the minimum required by APRA. ADIs can run scenarios based on one- or two-notch downgrades as additional contingencies. The team agrees with APRA's view, but suggests that APRA should align APS 210 and APG 210.

Annexes

Annex 1: RCAP Assessment Team and Review Team

Assessment Team Leader

Mr Ong Chong Tee	Deputy Managing Director (Financial Supervision) of the Monetary Authority of Singapore

Assessment Team members

Ms Nezahat Cesur	Banking Regulation and Supervision Agency of Turkey
Mr Peter Goodrich	Federal Reserve Bank of Chicago

Supporting members

Mr Ronald Sin Kin Tat	Monetary Authority of Singapore
Mr Lim Yunxiao	Monetary Authority of Singapore
Mr Nik Faris Sallahuddin	Basel Committee Secretariat
Mr Carlos Sosa	Basel Committee Secretariat
Mr Olivier Prato	Basel Committee Secretariat

Review Team

Mr Toshio Tsuiki	Basel Committee Secretariat
Mr Giorgio Donato	Bank of Italy
Ms Anne Lécuyer	European Central Bank, SSM
Mr Shigeo Kawauchi	Financial Services Agency of Japan

Annex 2: List of LCR standards under the Basel framework used for the assessment

Basel documents in scope of the assessment

- *The Liquidity Coverage Ratio (January 2013), including the frequently asked questions on Basel III's January 2013 Liquidity Coverage Ratio*, April 2014
- *Liquidity Coverage Ratio disclosure standards*, January 2014

Basel documents reviewed for information purposes

- *Basel III: The Liquidity Coverage Ratio and liquidity risk monitoring tools* (part on liquidity risk monitoring tools), January 2013
- *Monitoring tools for intraday liquidity management*, April 2013
- *Principles for sound liquidity risk management and supervision*, September 2008

Annex 3: Local regulations issued by APRA for implementing Basel LCR standards

Overview of issuance dates of important Australian LCR rules

All standards effective from 1 January 2015 — Table 2

Domestic regulations	Version and date
APS 210 Liquidity, www.legislation.gov.au/Details/F2017L00047	Effective January 2018. Released in December 2016 to add provisions for HQLA2B and the NSFR along with some changes to LCR sections. https://www.legislation.gov.au/Details/F2017L00047 *APS 330 Public Disclosure* (August 2015) https://www.legislation.gov.au/Details/F2015L01177 *Reporting Standard ARS 210.0 Liquidity* (November 2014) https://www.legislation.gov.au/Details/F2014L01583
APS 330 Public Disclosure, www.legislation.gov.au/Details/F2015L01177	Current; issued August 2015
Reporting Standard ARS 210.0 Liquidity, www.legislation.gov.au/Details/F2014L01583	Current; issued November 2014

Hierarchy of Australian laws and regulatory instruments

Table 3

Level of rules (in legal terms)	Description
Laws	Enacted by the Parliament of Australia.
Regulations	Regulations made under the *Banking Act 1959* are issued by the Governor-General on the recommendation of the Treasurer subsequent to the Treasurer's consultation with APRA.
Prudential standards	Issued by APRA.
Administrative instruments (eg conditions on banking authorities, directions)	Issued by APRA.
Other regulatory documents (eg prudential practice guides, other guidance and letters to industry)	Issued by APRA.

Annex 4: Details of the RCAP assessment process

Off-site evaluation

- Completion of a self-assessment questionnaire by APRA
- Evaluation of the self-assessment by the RCAP Assessment Team
- Independent comparison and evaluation of the domestic regulations issued by APRA with corresponding Basel III standards issued by the Basel Committee
- Identification of observations
- Refinement of the list of observations based on clarifications provided by APRA
- Assessment of materiality of deviations for all quantifiable deviations based on data and non-quantifiable deviations based on expert judgment
- Forwarding of the list of observations to APRA

On-site assessment

- Discussion of individual observations with APRA
- Meeting with selected Australian banks
- Discussion with APRA and revision of findings to reflect additional information received
- Assignment of component grades and overall grade
- Submission of the detailed findings to APRA with grades
- Receipt of comments on the detailed findings from APRA

Review and finalisation of the RCAP report

- Review of comments by the RCAP Assessment Team, finalisation of the draft report and forwarding to APRA for comments
- Review of APRA's comments by the RCAP Assessment Team
- Review of the draft report by the RCAP Review Team
- Reporting of findings to SIG by the Team Leader
- Review of the draft report by the Peer Review Board
- Approval of the report by the Basel Committee and publication

Annex 5: Assessment of bindingness of regulatory documents

The following table summarises the assessment of the seven criteria used by the Assessment Team to determine the eligibility of Australian regulatory documents.

Criterion	Assessment
(1) The instruments used are part of a well-defined, clear and transparent hierarchy of legal and regulatory framework.	The Banking Act provides the overarching legal framework regulating banking business in Australia. The Banking Act empowers APRA to grant authorities to carry on banking business to ADIs. Section 11AF of the Banking Act delegates to APRA the power to make legally enforceable standards in relation to prudential matters, including measures to keep an ADI in a sound financial position (Prudential Standards). Prudential Standards that apply to more than one specific ADI are legislative instruments, which means that they must be tabled in the Australian Parliament and are subject to a period of disallowance. The LCR framework has been implemented by APRA through Prudential Standards made under the power conferred on APRA in Section 11AF of the Banking Act. An integral component of APRA's prudential framework are prudential practice guides (PPGs) which are inextricably linked to the relevant Prudential Standards. They provide interpretation of the requirements set out in the prudential standards and detail best practice, adoption of which enables ADIs to demonstrate (to APRA) compliance with the Prudential Standards.
(2) They are public and easily accessible	APRA publishes its Prudential Standards and PPGs on its website. Prudential Standards that are legislative instruments, including those implementing the LCR framework, are required to be lodged on the Federal Register of Legislation and are available on the ComLaw website at www.legislation.gov.au.
(3) They are properly communicated and viewed as binding by banks as well as by the supervisors.	As legislative instruments made pursuant to powers under the Banking Act, Prudential Standards must be complied with by ADIs to which they apply. APRA consults widely on its proposed implementation of prudential standards. PPGs provide interpretation of the requirements set out in the Prudential Standards and detail best practice, adoption of which enables ADIs to demonstrate (to APRA) compliance with the Prudential Standards. In performing its supervisory role, APRA takes account of the regard given by ADIs to the PPGs. As a measure of their standing in APRA's prudential framework, APRA adopts the same level of consultation in drafting the PPGs as it does for the Prudential Standards.
(4) They would generally be expected to be legally upheld if challenged and are supported by precedent.	The Prudential Standard, including pre-LCR requirements, applying liquidity-related requirements has been in place since 2000. No legal challenges have been made in this time. APRA's Legal team has confirmed that it expects our Prudential Standard implementing the LCR framework would be upheld if challenged.
(5) Consequences of failure to comply are properly understood and carry the same practical effect as for the primary law or regulation.	As Prudential Standards are delegated legislation, the consequences of failure to comply with their requirements are widely known and accepted. In the event of non-compliance with whole or part of a Prudential Standard, APRA may issue a direction under Section 11CA of the Banking Act to an ADI to comply. Failure by an ADI to comply with a direction constitutes a criminal offence under Section 11CG of the Banking Act. An officer of an ADI may also be convicted of a criminal offence should the officer fail to take reasonable steps to ensure the ADI complies with the direction, and the officer's duties include ensuring that the ADI complies. With respect to the consequences of failure to have regard to PPGs, refer to Criterion 3.
(6) The regulatory provisions are expressed in clear language that complies with the Basel provisions in both substance and spirit.	Prudential Standards are expressed to strike a balance between clarity and enforceability, including imposing mandatory requirements (eg an ADI "must" do or not do something). APRA seeks to ensure compliance with the Basel rules texts using Basel language where appropriate, tailored to take account of local terminology, existing prudential requirements and accommodating efforts to harmonise prudential requirements across the insurance and banking sectors. PPGs provide interpretative guidance and an outline of best practice. Given the nature of these documents, words such as "it is APRA's view that", "best practice", "good practice" or "a prudent ADI would take this action" are used.

(7) The substance of the instrument is expected to remain in force for the foreseeable future	APRA has responsibility for making, varying and revoking Prudential Standards and fully intends that they will remain in force for the foreseeable future.

Annex 6: Key liquidity indicators of the Australia banking system

Data on a standalone basis as of 31 December 2016 — Table 4

Size of banking sector (AUD billions).		
Total assets of all banks operating in the jurisdiction (including off-balance sheet assets)	5,571	
Total assets of all major locally incorporated banks (including off-balance sheet assets)	4,851	
Total assets of locally incorporated banks to which liquidity standards under the Basel framework are applied (including off-balance sheet assets)	4,851	
Number of banks		
Number of banks operating in Australia (excluding local representative offices)	151	
Number of G-SIBs	0	
Number of D-SIBs	4	
Number of locally incorporated internationally active banks	15	
Number of locally incorporated banks required to implement Basel III liquidity standards	15	
Number of banks required to implement domestic liquidity standards[1]	136 APRA has alternative *quantitative* liquidity standards for small, less complex, locally incorporated banks and for foreign bank branches. The *qualitative* requirements in APS 210, which are formulated in line with the BCBS Principles for Sound Liquidity Risk Management and Supervision, are applicable to all regulated entities.	
Breakdown of LCR for five RCAP sample banks (AUD millions)	**Unweighted**	**Weighted**
Total HQLA	641,003	638,722
Level 1 HQLA	393,255	393,255
Level 2A HQLA	15,206	12,925
Level 2B HQLA	0	0
ALA HQLA	232,542	232,542
Total cash outflows	2,704,925	607,490
Retail and small business stable deposits	415,887	20,794
Retail and small business less stable deposits	501,806	68,029
Wholesale unsecured operational deposits	181,225	44,524
Wholesale unsecured non-operational funding	345,416	223,073
Secured funding	179,277	20,143
Debt issued instruments (incl. credit and liquidity facilities)	747,182	192,282
Other contractual outflows	14,333	2,818
Contingent funding obligations	319,798	35,826
Total cash inflows	313,102	127,149

Secured lending	184,268	20,878
Fully performing unsecured loans	71,591	49,028
Other cash inflows	57,243	57,243
LCR		133%

[1] APRA has alternative *quantitative* liquidity standards for small, less complex, locally incorporated banks and for foreign bank branches. The *qualitative* requirements in APS 210, which are formulated in line with the BCBS *Principles for sound liquidity risk management and supervision*, are applicable to all regulated entities.

Annex 7: Materiality assessment

As a general principle, and mirroring the established RCAP assessment methodology for risk-based capital standards, the RCAP-LCR materiality assessment is based on both quantitative and qualitative information with an overlay of expert judgment. Where possible, teams also take into account the dynamic nature of liquidity risks and seek to assess the materiality of deviation at different points in time.

In line with underlying RCAP principles, the quantitative materiality assessment for the LCR is based on a determination of the cumulative impact of all identified deviations (both quantifiable and non-quantifiable deviations). Where deviations are quantifiable, the Assessment Team will generally base the assessment on the highest impact that has been reported across three data points. The collection of data across different dates is agreed upon between the Team Leader and the assessed jurisdiction.

In the case of the Australia LCR assessment, 10 deviations were assessed on both a quantifiable and qualitative basis. The following table summarises the number of deviations according to their materiality.

Number of gaps/differences by component — Table 5

Component	Non-material	Potentially material	Material
Definition of HQLA (numerator)	2	0	1
Outflows (denominator)	6	0	0
Inflows (denominator)	1	0	0
LCR disclosure requirements	0	0	0

Note: materiality is defined based on quantitative benchmark thresholds (for the quantifiable gaps) and expert judgment (for the non-quantifiable gaps). See Section 2 with the detailed assessment findings for further information.

RCAP sample of banks

The following Australian banks were selected for materiality testing of the quantifiable deviations. Together, these banks hold about 92% of the total assets of locally incorporated, internationally active banks in the Australian banking system. The sample covers internationally active banks, and is a good representation of the various types of bank operating in Australia. The basis of materiality assessment is the impact on the reported liquidity ratio of the banks constituting the sample as agreed between the Assessment Team and the assessed jurisdiction.

RCAP sample banks — Table 6

Banking group	Share of banks' assets of the assets of internationally active banks in Australia
Australia and New Zealand Bank	23%
Commonwealth Bank of Australia	23%
Macquarie Bank Limited	4%
National Australia Bank Limited	20%
Westpac Banking Corporation	22%
Total	92%

Annex 8: Australia implementation of the liquidity monitoring tools

In addition to the minimum standard for the LCR, the Basel LCR framework also outlines the metrics to be used to monitor liquidity risks ("the monitoring tools"). The monitoring tools capture specific information related to a bank's cash flows, balance sheet structure, available unencumbered collateral and certain market indicators. The monitoring tools supplement the LCR standard and are a cornerstone for supervisors in assessing the liquidity risk of a bank. This annex provides a qualitative overview of the implementation of the monitoring tools in Australia.

Monitoring tool	APRA implementation
Contractual maturity mismatch Available unencumbered assets LCR by significant currency	APRA's suite of liquidity reporting forms comprises an all-currency LCR which includes significant currency HQLA/outflows/inflows (ARF 210.1A), AUD LCR (ARF 210.1B), spot contractual balance sheet maturity (ARF 210.3) and a balance sheet forecast (ARF 210.4).
Concentration of funding	APRA collects information relating to ADIs' large liability exposures (ARF 221). In addition, funding concentrations are assessed as part of routine supervision, primarily during on-site prudential reviews.
Market-related monitoring tools	APRA has a dedicated team responsible for identifying and assessing ADI specific risks. This includes analysing financial sector data and generating information for supervisors to use as part of routine supervisory activities.
Intraday liquidity management	APRA has not implemented any formal reporting to monitor intraday liquidity as the Reserve Bank of Australia has primary responsibility for regulating the payments system, which includes intraday liquidity management, and has robust reporting and monitoring processes in place. That said, APS 210 paragraphs 29 and 49 and APG 210 paragraphs 39–41 contain requirements for an ADI to explicitly consider intraday liquidity risk in formulating its liquidity management strategy and contingency funding plans. This is monitored as part of routine supervision, primarily during on-site prudential reviews.

Annex 9: Australia's implementation of the *Principles of sound liquidity risk management and supervision*

Fundamental principle for the management and supervision of liquidity risk – Principle 1

APRA fully endorses the need for ADIs to have a robust framework to manage liquidity risk. APS 210 details the requirement for ADIs to establish a framework and to maintain sufficient liquidity to meet obligations as they fall due and to hold a minimum level of high-quality liquid assets to survive a severe liquidity stress that may involve the loss or impairment of both secured and unsecured funding sources and may origination from ADI-specific, market-wide, or a combination of sources.

See APS 210 paragraphs 8–9, 23

Governance of liquidity risk management – Principles 2–4

APRA's prudential framework closely mirrors the principles outlining expectations for the effective governance of liquidity risk. This includes the need for a clearly expressed risk appetite/tolerance that is actively used to formulate liquidity strategy, policies and processes, clearly designated roles and responsibilities between the board and senior management and the requirement to establish a costs and benefits allocation process that appropriately apportions the costs of prudent liquidity management to the sources of liquidity risk and provides appropriate incentives to manage liquidity risk.

See APS 210 paragraphs 13, 15, 16(a), 16(i), 18, 39

Measurement and management of liquidity risk – Principles 5–12

Considerable emphasis is placed on robustness of the processes for identifying, measuring, monitoring and controlling liquidity risk. Consistent with the Basel Sound Principles, this includes an expectation that sufficiently granular analysis of liquidity needs across legal entities, key business lines, products and jurisdictions in which the ADI operates is undertaken including consideration of potential restrictions on the transferability of liquids. Intraday liquidity positions and related risk must be actively managed in order to meet payment and settlement obligations on a timely basis under both normal and stressed conditions.

ADIs are expected to develop and document an annual funding strategy that is reviewed on a regular basis and updated as necessary in light of changing funding conditions or a change in strategy to ensure estimates of funding capacity remain valid. Stress testing is a key tool for identifying sources of potential liquidity strain and ensuring that current exposures remain in accordance with the approved liquidity risk tolerance. The stress test outcomes must also be used to adjust liquidity management strategies, policies and positions including assisting the development of contingency plans that clearly set out the strategies for addressing liquidity shortfalls in emergency situations.

See APS 210 paragraphs 23, 26(c), 28, 33, 35, 38, 41, 43–45, 55–56 and Attachment A, paragraph 28.

Public disclosure – Principle 13

APRA requires LCR ADIs to publicly disclose quantitative and qualitative information on their LCRs. These disclosures are consistent with the Basel-prescribed disclosure template and disclosure requirements.

See APS 330 paragraphs 18-19 and Attachment F

The role of supervisors – Principles 14–17

APRA requires ongoing review of the liquidity risk management framework as a fundamental requirement in APS 210. In addition, APRA requires a triennial comprehensive review of the effectiveness of the risk management framework, of which liquidity risk is a material risk, by operationally independent, appropriately trained and competent persons. The scope of the review is adjusted to the size, business mix and complexity of the ADI.

APRA's supervision framework for ongoing supervision includes APRA's implementation of the monitoring tools outlined in Annex 9 and comprises a mix of internal reports and data as well as external market information.

APRA has a range of supervisory responses available to it to address weaknesses in an ADI's liquidity risk management framework or where it holds excessive liquidity risk.

APRA regularly engages with other financial sector agencies and government bodies at multiple levels of seniority and across a variety of forums. The frequency of meetings takes into consideration current operating conditions that may result in the need for increased information-sharing. In addition, there are interactions specifically relating to liquidity risk.

See APS 210 paragraph 32, CPS 220 paragraphs 45–48

Annex 10: Areas for further guidance from the Basel Committee

The Assessment Team listed the following issues for further guidance from the Basel Committee:

Scope of application: Using host liquidity parameters in Alternative Liquidity Approaches (ALA)

Basel requires that, when calculating the LCR on a consolidated basis, a cross-border banking group should apply the liquidity parameters adopted in the home jurisdiction to all legal entities being consolidated except for the treatment of retail and SME deposits. However, APRA also allows for the cross-border banking group to adopt the ALA parameters set by the host supervisors. The Assessment Team understands the rationale for APRA to adopt such an approach. While the ALA approach is clearly specified in the LCR standard, the application issue for the ALA in the context of the differences between the home and host liquidity requirements is not clearly addressed in the Basel LCR standard. In this regard, the Assessment Team considers that this is a topic that would benefit from further discussions within the Basel Committee or clarification by it to promote more consistent application of the LCR standard.

Scope of application: Alternative treatments in non-Basel jurisdictions

The Australian regulation allows locally incorporated ADIs with New Zealand subsidiary operations to include all securities eligible for market operations with the Reserve Bank of New Zealand, notwithstanding some of those securities would not meet the requirements for Level 1 or Level 2 HQLA in the Basel LCR standard. As in the case of the Australian market, the New Zealand has an insufficient supply of eligible Level 1 and Level 2 assets in the domestic currency to meet the aggregate demand of ADIs with significant exposures in this currency. Given this shortage of government securities and since New Zealand is not a member of the Basel committee, APRA recognised the NZ supervisory liquidity regime, which allows a broader range of securities eligible as HQLA than is allowed under the Basel LCR, as acceptable and determined that it would accept all RBNZ-eligible assets for the New Zealand subsidiaries of ADIs. . While the LCR allows the Alternative Liquidity Approaches (ALA) for jurisdictions without active, deep and liquid markets, New Zealand is not a member of the Basel committee and has therefore implemented a supervisory liquidity regime that is different from the Basel LCR. The Basel LCR Standard does not prescribe any specific treatment for banks operating in non-Basel Committee jurisdictions with an insufficient supply of HQLA. The Assessment Team considers that this is another topic that would benefit from further discussions within the Basel Committee or from a clarification to promote more consistent application of the LCR standard.

Annex 11: List of issues for follow-up RCAP assessments

The Assessment Team identified the following issue listed below for follow-up and for future RCAP assessments of Australia:

High-quality liquid assets (numerator)

The Basel standard restricts the numerator of the LCR to the stock of HQLA. In order to qualify as HQLA, assets should be liquid in markets during a time of stress and, ideally, be central bank-eligible. The Basel standard includes additional characteristics for HQLA as well as specific requirements for Level 1 and Level 2 HQLA. The Australian regulation allows locally incorporated ADIs with New Zealand subsidiary operations to include all securities eligible for market operations with the Reserve Bank of New Zealand, notwithstanding some of those securities would not meet the requirements for Level 1 or Level 2 HQLA in the Basel LCR. Since New Zealand is not a member of the Basel Committee and has implemented a supervisory liquidity regime that is different from the Basel LCR standard and allows a broader range of securities eligible as HQLA than is allowed under the Basel LCR. The Assessment Team recommends a future follow-up assessment to determine further the materiality of this deviation.

Annex 12: Areas where Australia LCR rules are stricter than the Basel standards

In two areas APRA has adopted a stricter approach than the minimum standards prescribed by Basel.

- APRA adopts a conservative approach to wholesale funding maturity, requiring the liability to be recognised at the earliest contractual opportunity, regardless of whether the option is held by the investor or the issuer. The Basel text only requires supervisors to take into account reputational factors, which may or may not result in the liability being modelled at the earliest contractual opportunity.
- APRA has not opted to phase in implementation of the LCR – regulated entities were required to meet a 100% LCR from 1 January 2015.

It should be noted that this treatment has not been taken into account as a mitigant in the overall assessment.

Annex 13: Implementation of LCR elements subject to prudential judgment or discretion in Australia

The following tables provide information on elements of LCR implementation that are subject to prudential judgment and national discretion. The information provided helps the Basel Committee to identify implementation issues where clarifications and (additional) FAQs could improve the quality and consistency of implementation. It should also inform the preliminary design of any peer comparison of consistency across the membership that the Committee may decide to conduct, in similar fashion to the studies on risk-weighted asset variation for the capital standards.

Elements requiring judgment (non-exhaustive list) — Table 8

Basel paragraph	Description	Implementation by the Australian authorities
24(f)	Treatment of the concept of "large, deep and active markets"	APRA abides by the characteristics of HQLA as set out in paragraphs 24–27 of the Basel guidance, which can be seen in APRA's July 2016 media release regarding eligible AUD HQLA: www.apra.gov.au/MediaReleases/Pages/16_22.aspx. APRA did not include the characteristics set out in paragraphs 24–27 in its Standards as ADIs have no discretion to determine what qualifies as AUD HQLA. APRA has followed, and will continue to follow the Basel guidance on HQLA characteristics when determining eligible AUD HQLA. Prior to implementation of the LCR, APRA reviewed a range of marketable instruments denominated in AUD against the Basel III criteria for HQLA, including the need for the assets to be traded in large, deep and active repo or cash markets. As noted in APRA's December 2013 Response to Consultation – "APRA considered the range of possible AUD debt securities against the qualifying criteria, taking into account the amount of these instruments on issue, the degree to which the instruments are broadly or narrowly held, and the degree to which the instruments are traded in large, deep and active markets."
50	Treatment of the concept of "reliable source of liquidity"	As stated above, APRA has followed, and will continue to follow the Basel guidance on HQLA characteristics when determining eligible AUD HQLA. Prior to implementation of the LCR, APRA reviewed a range of marketable instruments denominated in AUD against the Basel III criteria for HQLA, including the need for the assets to be a reliable source of liquidity. As noted in APRA's December 2013 Response to Consultation – "APRA gave particular attention to the liquidity of these instruments during the market disruptions of 2007–2009 in the more acute phases of the global financial crisis."
52	Treatment of the concept of "relevant period of significant liquidity stress"	At a minimum, APRA considers the relevant period of significant liquidity stress as periods with similar liquidity characteristics to the 2007–09 global financial crisis. As noted in APRA's December 2013 Response to Consultation – "APRA gave particular attention to the liquidity of these instruments during the market disruptions of 2007–2009 in the more acute phases of the global financial crisis."
74–84	Retail deposits are divided into "stable" and "less stable"	Retail deposits are divided into three categories – stable, less stable and higher run-off less stable – based on the criteria in the Basel guidance. Stable deposits are the portion of deposits that are fully covered by the Financial Claims Scheme (or an effective deposit insurance scheme) where the depositors have an established relationship with the ADI that makes deposit withdrawal highly unlikely or the deposits are in transactional accounts. Less stable deposits are the portion of deposits that do not meet the requirements

		of stable deposits. Depending on the classification per APS 210 paragraphs 33–39, retail deposits may receive a run-off rate between 5 and 25%.
83 (retail), 86 (wholesale)	Treatment of the possibility of early withdrawal of funding with maturity above 30 days	APRA has adopted the Basel guidance regarding the treatment of early withdrawal of funding with maturity above 30 days. <u>Retail deposits</u> APS 210 Attachment A paragraphs 41–42 "If an ADI allows a depositor to withdraw such deposits despite a clause that says the depositor has no legal right to withdraw, the entire category of these funds must be treated as demand deposits. However, an ADI can allow depositors experiencing hardship to withdraw their term deposits without changing the treatment of the entire pool of deposits." <u>Wholesale funding</u> APS 210 Attachment A paragraph 44 "Wholesale funding included in the LCR is defined as all funding that is callable within the LCR's horizon of 30 days or that has its earliest possible contractual maturity date within this horizon (such as maturing term deposits and unsecured debt securities), as well as funding with an undetermined maturity. This must include all funding with options that are exercisable at the investor's discretion within the 30-day horizon. Wholesale funding that is callable by the provider of the funds, subject to a contractually defined and binding notice period surpassing the 30-day horizon, may be excluded."
90–91	Definition of exposure to small business customers	APRA has implemented an AUD threshold of AUD 2 million for the purposes of defining small business customers.
94–103	Deposits subject to "operational" relationships	APRA has adopted the Basel guidance regarding the definition of operational deposits, including explicit requirements relating to qualifying activities (eg clearing, custody or cash management), qualifying deposits (eg by-product of the underlying services, not offered in the wholesale market in the sole interest of offering interest income, held in specially designated accounts with no incentive to leave excess funds) and quantitative and qualitative criteria (eg requirement to calculate the portion of the deposit deemed to be operational purposes, requirement for a legally binding agreement, practical impediment to withdraw funds, exclusion of correspondent banking).
131(f)	Definition of other financial institutions and other legal entities	APRA includes a definition of financial institution in the prudential standards. APS 001 paragraph 4 "Financial institution includes any institution engaged substantively in one or more of the following activities – banking; leasing; issuing credit cards; portfolio management (including asset management and funds management); management of securitisation schemes; equity and/or debt securities, futures and commodity trading and broking; custodial and safekeeping services; insurance (both general and life) and similar activities that are ancillary to the conduct of these activities. A financial institution includes any authorised NOHC or overseas equivalent." APS 210 paragraph 7 "The following definitions apply in this Prudential Standard: (b) financial institution – an entity within the meaning of paragraph 4 of APS 001. For the avoidance of doubt, this definition includes money market corporations, finance companies, friendly societies and the trustees of superannuation/pension funds, public unit trusts/mutual funds and cash management trusts"

Elements left to national discretion (non-exhaustive list)

Table 8

Basel paragraph	Description	Implementation by the Australian authorities
5	Parameters with elements of national discretion should be transparent to provide clarity both within the jurisdiction and internationally.	Where APRA has opted to exercise national discretion to reflect Australia-specific conditions, the effected parameters are clearly outlined in the relevant prudential or reporting standards, which are publicly available on APRA's website.
8	Use of phase-in options	APRA has not opted to phase in implementation of the LCR – regulated entities were required to meet a 100% LCR from 1 January 2015.
11	Supervisory guidance on HQLA usability; implementation schedule for countries receiving financial support for macroeconomic and structural reform purposes	APRA recognises that during a period of financial stress, an ADI may need to liquidate part of its stock of HQLA and/or draw on its Committed Liquidity Facility (CLF) with the Reserve Bank of Australia (RBA), using the cash generated to cover cash outflows; as a consequence, the LCR may fall below the minimum level required. APRA's supervisory response to a breach of an ADI's LCR requirement will be appropriate to the circumstances. Australia is not receiving financial support for macroeconomic and structural reform.
50(b)	Eligibility of central bank reserves	APRA has included in its prudential standard the requirement that central bank balances are able to be drawn down in times of stress, consistent with the wording in the Basel guidance. In the Australian context, reserves at the RBA are eligible as Level 1 assets. These reserves are held in Exchange Settlement Accounts (ESA) and are able to be used in times of stress – the operation of the CLF is dependent on access to these funds.
50(c)	Marketable securities that are assigned a 0% risk-weight under the Basel II Standardised Approach for credit risk	APRA has implemented the Basel framework in relation to Level 1 assets.
53–54	Eligible Level 2B assets	APRA has implemented the Basel framework in relation to Level 2B assets but has determined that there are no eligible *Australian dollar* Level 2B assets.
54a	Provision relating to the use of restricted contractual committed liquidity facilities[1]	N/A
55(f)	Treatment for jurisdictions with insufficient HQLA (subject to separate peer review process)	In December 2010, APRA and the RBA announced that ADIs subject to the LCR will be able to establish a CLF with the RBA. The CLF is intended to be sufficient in size to compensate for the lack of sufficient HQLA (mainly Australian Government and semi-government securities) in Australia for ADIs to meet their LCR requirements.
68	Treatment of Shariah-compliant banks	N/A
78	Treatment of deposit insurance	The deposit insurance scheme in Australia, the Financial Claims Scheme, is not pre-funded and, as such, the 3% run-off rate for retail deposits is not relevant for domestic deposits.

79(f)	Categories and run-off rates for less stable deposits	APRA has implemented two run-off rates for less stable retail deposits – 10% and 25%. Deposits are categorised using a "scorecard" which assesses characteristics consistent with the Basel guidance – ie deposit size, propensity to withdraw based on access method and price sensitivity.
123	Market valuation changes on derivative transactions	APRA has adopted the default historical 24-month largest absolute net 30-day collateral flow as described in the Basel guidance.
134–140	Run-off rates for other contingent funding liabilities	APRA has specified the following run-off rates for contingent funding obligations: - Unconditionally revocable credit and liquidity facilities – 5% - Trade finance related obligations – average of actual monthly net outflows in a recent 12-month period - Guarantees and letter of credit – 50% of the average of actual monthly net outflows in a recent 12-month period - Buybacks of domestic Australian debt securities – 10% for short-term securities and 5% for long-term securities - Non-contractual obligations related to structured products and managed funds – 5%
160	Weight assigned to other contractual inflows	APRA has assigned a 100% run-off rate for "other contractual inflows".
164–165	Scope of application and scope of consolidation of entities within a banking group	APRA determines which ADIs are subject to the LCR or an alternate liquidity regime. In making this determination, APRA will give consideration to an ADI's size and complexity with respect to liquidity risk including whether an ADI is internationally active.
168–170	Differences in home/host liquidity requirements due to national discretions	Where an ADI has a banking presence (branch or subsidiary) in other jurisdictions, the ADI in calculating its consolidated LCR must apply the requirements outlined in APRA's prudential standards. The only exceptions are: (a) for retail and small and medium enterprise (SME) deposits, where the host supervisors' outflow assumptions must be applied; and (b) alternative liquid assets, as provided for in the Basel Committee on Banking Supervision's (Basel Committee) global framework for liquidity risk and allowed by the host supervisor, can be included. Where an ADI has a banking presence (branch or subsidiary) in jurisdictions that do not apply the Basel Committee's global framework for liquidity risk, the cash flow assumptions outlined in APS 210 must be applied in calculating its consolidated LCR.
Annex 2	Principles for assessing eligibility for ALA	APRA has implemented the principles as part of the contractual terms of the facility, the annual CLF size assessment as well as periodic consideration of pricing and availability of HQLA.

[1] See www.bis.org/publ/bcbs274.htm.