

Australian Prudential Regulation Authority

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John F. Laker AO
CHAIRMAN

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Mr Jason McNamara
Executive Director
Office of Best Practice Regulation
Department of Finance and Deregulation
John Gorton Building
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Dear Mr McNamara

**REGULATION IMPACT STATEMENT
IMPLEMENTING BASEL III LIQUIDITY REFORMS IN AUSTRALIA**

I am writing in relation to the attached Regulation Impact Statement (RIS) prepared by the Australian Prudential Regulation Authority for the implementation of Basel III liquidity in Australia.

I am satisfied that the RIS meets the Government's best practice regulation requirements, in particular that:

- the problem being addressed and the objectives of government action are well articulated;
- all feasible options are considered;
- the analysis of the likely impacts of each option is adequate and presented in a balanced way; and
- the conclusion is supported by the analysis in the RIS.

I submit the RIS to the Office of Best Practice Regulation for formal assessment.

Yours sincerely,

Signed - Dr John Laker

Appendix: APRA's responses to items raised by the OBPR on the 1st pass RIS

Problem

OBPR issue

1. The RIS should give a more detailed description of how the current environment in Australia compares to the desired environment which would be achieved under Basel III.
 - (a) What is the regulatory gap compared to Basel III?
 - (b) Where does current industry practice lag compared to the requirement of Basel III?
 - (c) What are the liquidity buffers held by industry currently, including any responses to the GFC?

APRA response

In the 'Background' section, commencing on page 4, a discussion of the Status Quo has been added. This includes an outline of the current regulatory framework where the key quantitative metric used to supervise LCR ADIs is the five day 'name crisis'. The discussion identifies the differences between the old and new regulatory frameworks as well as outlining how industry has already evolved some way toward Basel III compliance.

This section makes clear that while LCR ADIs have some way to go in terms of the holding of high-quality liquid assets (HQLA), they have made material improvements in this respect since the financial crisis of 2007 to 2009. Hence the Status Quo is defined with this in mind.

OBPR issue

2. In regard to the size and scope of the issue, the Problem Section should also provide an overview of the industry structure, including where the systemic risks are considered to be concentrated.
 - (a) How much of the market is captured by the 40 large ADIs which will be subject to the liquidity coverage ratio (LCR), and what proportion of the market does this represent?

APRA response

A paragraph has been added to the end of the section 'Background: APRA's existing liquidity framework' that outlines the entity scope of the LCR. This clarifies that LCR ADIs make up over 95 per cent of the ADI industry (as measured on total balance sheet size) and that there is a concentration of banking in Australia within the four major banks that comprise over 75 per cent of the Australian bank balance sheet.

Objectives

OBPR issue

3. The objective pre-justifies two key proposals, i.e.:
 - (a) To not allow staged implementation as permitted by the Basel Committee.
 - (b) To limit the definition of HQLA in Australia to Commonwealth government securities and semi-government securities, although a broader definition is permitted under Basel III.

These proposals cannot be introduced as decisions in the Objective Section. Rather they need to be outlined as options, which are then assessed in the Impact Analysis Section.

APRA response

The justifications for allowing a staged implementation and the narrow definition of HQLA have been removed from the 'Objectives of APRA's initiative' section of the RIS. These topics are now addressed in the 'Options' section specifically under 'Option 3 - fully implement Basel III liquidity'.

Impacts

OBPR issue

4. The discussion in the Impact Analysis Section should flow from the definition of the Status Quo in the Problem Section, with costs and benefits assessed as changes from this in a consistent manner.
 - (a) The RIS currently treats the Status Quo inconsistently. At points of discussion on costs the Status Quo includes industry already adjusting to the proposed requirements, which tends to reduce industry costs from the proposal, whereas in the discussion of the benefits, the Status Quo does not appear to be defined to include such developments (and their inclusion would tend to lower the overall benefits).

It should be made sure that all of the discussion in the RIS, including in the Conclusion, is consistent in this treatment of the Status Quo.

APRA response

The Status Quo has been clearly defined in the 'Problem' section as is outlined in response to issue 1 above. The treatment of the Status Quo has been aligned across the RIS such that it is now clear that APRA considers the Status Quo to be what would have occurred specifically if APRA chose not to implement Basel III liquidity.

Parts of the discussion in the RIS still consider the improvements that have been made by industry since the extremes of the global financial crisis of 2007 to 2009; these are retained in the RIS for the benefit of historical context.

OBPR issue

5. It is unclear from the discussion in the RIS what the magnitude is of the proposed changes.

APRA response

A clear statement of the overall magnitude of the implementation of Basel III liquidity is included in the 'Impact Analysis' section under the sub-heading 'Assessment of costs and benefits' on page 10.

OBPR issue

6. The RIS notes various implementation costs for the LCR and NSFR, including additional reporting requirements/forms, intra-day liquidity reporting for those ADIs with material exposures, and additional liquidity disclosure requirements. The nature of these compliance costs should be discussed in more detail, in particular what will be required for business in terms of IT infrastructure, systems, staffing hours, training, ongoing costs etc. These costs should be estimated using the Business Cost Calculator and reported in the required format.

- (a) These compliance costs will also need to be offset using the same methodology.

APRA response

APRA has engaged the OBPR with regard to the appropriate estimation of the costs and cost offsets within the RIS. The cost estimates within the RIS have been updated to reflect these discussions.

Consultation

OBPR issue

7. The Consultation Section notes that ADIs were concerned with the accelerated implementation timetable (i.e. the decision to not adopt the staggered implementation offered by the Basel Committee).

- (a) The RIS needs to respond to this concern of ADIs more fully. The RIS needs to articulate why it was considered that there was an overall net benefit from the accelerated implementation despite the concerns raised by ADIs.

APRA response

The 'Consultation' section of the RIS has been updated to include more robust justifications of this policy stance.

OBPR issue

8. ADIs were also concerned of APRA's interpretation that the supply of HQLA in Australia is limited to Commonwealth government securities and semi-government securities.

- (a) This also requires further discussion. The RIS notes that the alternative assets that were proposed by stakeholders would not meet the Basel criteria. However, the RIS should include further detail on the objections presented by industry to this assessment. Also, the RIS should discuss the potential to use other financial assets which would meet the Basel requirement, and whether this would allay ADI concerns.

APRA response

The 'Consultation' section of the RIS has been updated to include more robust justifications of this policy stance. This includes the acknowledgement of industry concerns as well as a discussion of the assets that have been considered and the appropriate reasons for not including them within the pool of eligible HQLA.