

## RCAP jurisdictional assessments: self-reporting monitoring template for RCAP follow-up actions

Jurisdiction: Australia

Status as of: 31 December 2016

With reference to RCAP report(s): RCAP Assessment of Basel III regulations – Australia (March 2014)

### Part A<sup>1</sup>

Post-RCAP follow up: Changes applied to local regulations of the Basel Framework relating to risk-based capital standards (RCAP-Capital)

Table A

(1) Issue and/or relevant Basel paragraph number(s)	(2) Detailed description of finding (please indicate as precisely as possible the finding as identified in the relevant RCAP assessment report)	(3) Detailed reference to the domestic legislation/regulation that addresses the finding	(4) Summary description of amendment or rectification made
Basel III – paragraphs 52 –53	APRA has not explicitly stated that the criteria for inclusion in common equity criteria apply to non-joint stock companies. Footnote 12 to paragraph 53 of Basel III states the common equity criteria also applies to non-joint stock companies, such as mutual, cooperatives or savings institutions. However, APRA applies its capital standards under the Basel Framework to all domestically incorporated authorised deposit-taking institutions (ADIs), including those mutually	<i>Prudential Standard APS 111 Capital Adequacy: Measurement of Capital</i> (APS 111), paragraph 19, Attachments B and K	APRA has amended its prudential requirements to recognise ‘mutual equity interests’ that effectively apply the criteria for shares of mutually owned ADIs on conversion of Additional Tier 1 or Tier 2 instruments. APRA is developing tailored criteria for common equity instruments that may in future be issued by mutually owned ADIs. Currently, all of the Basel III criteria apply to common equity of non-joint stock companies, which effectively precludes these entities from issuing common equity instruments.

<sup>1</sup> To be completed only for those findings where action has been taken or initiated. Any plans for addressing other findings may be indicated in Part B.

	owned by members. APRA has indicated that work is still being finalised on specifically addressing how the common share criteria will apply to non-joint stock companies and any changes to Prudential Standards will be communicated once the work is finished.		
Basel III paragraphs 131, 147 and 148	Because of the inadvertent omission of a 'less than or equal' symbol, the minimum capital conservation ratio according to the table in <i>Prudential Standard APS 110 Capital Adequacy</i> (APS 110) Attachment B paragraph 1 for an ADI with a CET1 ratio of 5.125% and CET1 prudential capital requirement of 4.5% would be 80%, whereas according to the table of Basel III paragraph 131 it would be 100%.	APS 110 Attachment B paragraph 1 Table 1	APRA has now rectified this omission.
Basel III paragraphs 132(a)-(b)	With reference to the capital conservation buffer, Basel III stipulates where a bank does not have positive earnings and has a CET1 ratio less than 7%, it would be restricted from making positive net distributions.	APS 110 Attachment B paragraph 3	APRA has now rectified this omission.
Basel III paragraph 149	APRA's standards did not explicitly state that the calculation and disclosure of an ADI's countercyclical capital buffer should be based on the latest relevant jurisdictional countercyclical buffers that are available at the date they calculate their minimum capital requirement.	<i>Prudential Standard APS 330 Public Disclosure</i> (APS 330) Attachment A Table 1A item 64	APRA has now rectified this omission.
Basel II paragraph 60	<i>Prudential Standard APS 112 Capital Adequacy: Standardised Approach to Credit Risk</i> (APS 112) does not include the sovereign floor whereby no claim on an unrated bank may receive a risk weight lower than that applied to claims on its sovereign of incorporation.	APS 112 Attachment A item 9	APRA is revising APS 112 and, under the measures subject to consultation in 2016, proposed to incorporate the sovereign floor. This issue will be rectified when APS 112 is finalised.
Basel II paragraph 82	APRA standards do not include the statement regarding counterparty risk weightings for OTC derivative transactions will not be subject to any specific ceiling.	APS 112 Attachment B paragraph 10	APRA is revising APS 112 and, under the measures subject to consultation in 2016, proposed to incorporate the statement that counterparty risk weightings for OTC derivative transactions will not be subject to any specific ceiling in draft <i>Prudential Standard APS 180 Capital</i>

			<i>Adequacy: Counterparty Credit Risk</i> (APS 180) Attachment E paragraph 10. This issue will be rectified when APS 180 is finalised.
Basel II paragraph 539	Basel II paragraph 539 demands for a traditional securitisation at least two different stratified risk positions or tranches reflecting different degrees of credit risk. According to APS 120 paragraph 12(s), a warehouse SPV is a securitisation even if it does not have at least two different tranches of creditors or securities.	<i>Prudential Standard APS 120 Securitisation</i> (APS 120) paragraph 11(s) (effective January 2018)	In 2016, APRA released a revised APS 120 (which will be effective from 1 January 2018) under which the definition of securitisation does not include the reference to warehouse SPVs with only one tranche. This issue will be rectified when the new APS 120 takes effect.
Basel II paragraph 608	Under Basel II paragraph 608, where there is no specific Internal Ratings- based (IRB) treatment for the underlying asset type, originating banks that have received approval to use the IRB approach must calculate capital charges on their securitisation exposures using the standardised approach in the securitisation framework and investing banks with approval to use the IRB approach must apply the Ratings-Based Approach (RBA). APRA has not implemented this provision.	APS 120 (effective January 2018)	APRA notes that Basel II paragraph 608 has since been revised by the Basel Committee's July 2016 <i>Revisions to the securitisation framework</i> . Further, the IRB approach has not been included in APRA's revised securitisation framework and as a result this issue will no longer be applicable.
Basel II paragraphs 609 and 619	Pursuant to Basel II paragraph 609, the RBA must be applied to securitisation exposures that are rated, or where a rating can be inferred. Where an external or an inferred rating is not available, either the Supervisory Formula Approach (SFA) or the Internal Assessment Approach (IAA) must be applied. The IAA is only available to exposures (eg liquidity facilities and credit enhancements) that banks (including third-party banks) extend to ABCP programmes. In contrast, APS 120 Attachment D paragraph 2 does not restrict the IAA to exposures that banks extend to ABCP programmes. Instead, subject to APRA's approval, the IAA could also be used for facilities that the ADI extends to another kind of securitisation, where the RBA and the SFA cannot be used.	APS 120 (effective January 2018)	The IRB approach (including the IAA) for securitisation exposures has not been included in APRA's revised securitisation framework and as a result this issue will no longer be applicable.

Basel II paragraph 629	APRA did not implement one requirement relating to the calculation of regulatory capital requirements under the IRB approach for securitisation. (APS 120 Attachment B paragraph 15 and Attachment D paragraph 35)	APS 120 (effective January 2018)	The IRB approach for securitisation exposures has not been included in APRA's revised securitisation framework and as a result this issue will no longer be applicable.
Basel II paragraph 660	The qualifying criteria for the standardised approach to operational risk were not explicitly mentioned in <i>Prudential Standard APS 114 Capital Adequacy: Standardised Approach to Operational Risk</i> . The risk management standard <i>Prudential Standard CPS 220 Risk Management (CPS 220)</i> , which will come into place in January 2015, incorporates the Basel II qualifying requirements.	CPS 220 paragraphs 13, 21-27	APRA has rectified this issue: CPS 220 came into effect on 1 January 2015 and includes the qualifying criteria.
Basel II paragraph 30	APRA did not require ADIs to include the main features of capital instruments in their published Pillar 3 reports or provide a link to these disclosures.	APS 330 paragraphs 9 and 31 and Attachment B	APRA has rectified this omission.
Basel II Table 8, as amended by Basel II.5	APRA omitted some parts of the table relating to counterparty credit risk.	APS 330 Attachment D Table 11	APRA has rectified this omission.
Basel II Table 11, as amended by Basel II.5	APRA omitted some parts of this table relating to market risk disclosures for banks using the internal models approach for trading portfolios.	APS 330 Attachment D Table 14	APRA has rectified this omission.

## Part B

The RCAP report identified the following material or potentially material differences between the Basel capital framework and APRA's prudential requirements:

- Basel III paragraph 78 requires a bank's investments in its own capital, whether held directly or indirectly, to be deducted from regulatory capital, including any stock which the bank could be contractually obliged to purchase. APRA permits an ADI to include instruments in regulatory capital that it has indirectly funded in the following circumstances: where the instruments are purchased by a borrower as part of a well-diversified and well-collateralised portfolio under a full recourse loan provided by the ADI; where the instruments are funded by third parties (e.g. life insurance policyholders), who bear the risks and rewards and are responsible for decisions to buy and sell; and where the ADI holds its own shares on behalf of employees under a share-based employment remuneration scheme. APRA has not changed its view that these provisions do not conflict with the Basel III definition of 'indirect holdings' namely, 'exposures that will result in a loss to the bank substantially equivalent to any loss in the direct holding' and therefore does not intend removing these exemptions.
- APRA did not apply the Basel II paragraph 44 1.06 scaling factor to specialised lending exposures subject to the slotting approach under the IRB approach to credit risk. APRA will review this item as part of its implementation of the revised credit risk framework.
- For IRB banks, APRA allows mortgage loans to be eligible for retail treatment regardless of the occupancy status of the borrower, whereas a literal reading of Basel III paragraph 231 limits this treatment to owner-occupiers. APRA will review its approach as part of its implementation of the revised Basel credit risk framework.
- The Basel III point of non-viability requirements (paragraphs 1-4, 5-7 of the 13 January 2011 press release) specify the trigger event as the earlier of a determination that a bank would be non-viable without write-off and the decision to make a public sector injection of capital or equivalent support. APRA's requirements do not guarantee that the issuance of any new shares will occur prior to any public sector assistance. APRA remains of the view that adopting the Basel III approach might give rise to moral hazard, given public sector capital support for a banking institution is virtually unprecedented in Australia, and APRA does not wish to use language suggesting that such support may be forthcoming for any ADI.

The RCAP report also identified a number of non-material deviations from the Basel framework. Since the report was finalised in 2014, however, the Basel Committee has undertaken comprehensive reviews of many aspects of Basel II, including requirements relating to the scope of regulatory consolidation, the standardised and IRB approaches to credit risk, market risk, operational risk and reducing risk-weight variability. APRA has deferred making what in most instances are minor changes pending the outcome of these reviews.

Also affected by this decision are two non-material deviations that APRA specifically undertook to review and which are listed in Annex 6 to the RCAP report:

- *Prudential Standard APS 113 Capital Adequacy: Internal Ratings-based Approach to Credit Risk* has a wider definition of public sector entities (PSEs) that may be treated in an equivalent manner to sovereigns by including overseas local governments and non-commercial PSEs (Basel II paragraph 229); and

- APRA's prudential framework does not clearly exclude specified positions from the trading book definition (Basel II paragraph 16, including footnote 3 and as amended by Basel II.5).

APRA has not addressed the following outstanding items about securitisation also listed in Annex 6:

- The RCAP noted that APRA did not comply with paragraph 590 of Basel II, which sets out capital requirements for exposures in a securitisation structure that are revolving in nature. APRA's exclusion of redrawable home loans from the definition of a revolving securitisation was considered to be a deviation from the Basel framework. APRA remains of the view that the revolving securitisation requirements apply to facilities such as credit cards and not to draws on residential mortgage loans, the amounts for which are in any event immaterial relative to the size of the pool.
- Paragraphs 569 and 570 of Basel II relating to recognition of external credit assessments are no longer relevant under the Basel Committee's July 2016 *Revisions to the securitisation framework*. However, APRA continues to require lower-rated exposures to be deducted from CET1, not risk-weighted at 1250 per cent (Basel III paragraph 90).

Two additional items about the definition of capital listed in Annex 6 have yet to be resolved because APRA has deferred its proposed review of APS 111 pending finalisation of the revised Basel Committee framework. These items are:

- the requirement that deferred tax liabilities permitted to be netted against deferred tax assets must exclude amounts that have been netted against the deduction of goodwill, intangibles and defined superannuation assets (Basel III, paragraphs 69-70); and
- the requirement with regard to derivative liabilities that all accounting valuation adjustments arising from the bank's own credit risk must be derecognised and the offsetting between valuation adjustments arising from the bank's own credit risk and those arising from its counterparties' credit risk is not allowed (Basel III, paragraph 75, amended by the Basel Committee's press release of 25 July 2012).

As part of its review of APS 111, APRA will also take account of other items identified in the RCAP report relating to the definition of capital, such as the treatment of some investments in commercial entities and upfront fee income.