AFMA

12 May 2017

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General Manager
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Australian Prudential Regulation Authority
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SYDNEY NSW 2001

By email: Basel3liquidity@apra.gov.au

Dear Ms Richards

**Proposed Revisions to Reporting Standard ARS 210.0 Liquidity**

The Australian Financial Markets Association (AFMA) welcomes the opportunity to make this submission commenting on the revisions to Reporting Standard *ARS 210.0 Liquidity* as proposed in APRA's consultation released on 24 March 2017. In this regard, AFMA welcomes the informal extension of the consultation period until 12 May 2017.

We have consulted with our ADI members and with the exception of APRA's proposals with regard to the introduction of new reporting on the *Net Stable Funding Ratio* (NSFR), our comments reflect the views and concerns expressed by our foreign ADI membership. Comments with regard to NSFR are specific to the Required Stable Funding (RSF) factor applicable for an open reverse repo, and reflect the views and concerns of our major NSFR bank members.

AFMA notes that the revised reporting requirements will take effect from 1 January 2018.

## 1. Comments specific to the revisions as proposed

### 1.1 Reporting basis

The reporting basis as proposed is defined as the last business day of the relevant reporting period, requiring *reporting in accordance with the Australian Accounting Standards unless otherwise specified*. As these standards generally require reporting as at the last calendar day of the reporting period, this deviation from the generally accepted accounting principles introduces operational difficulties and additional reporting burdens, including due to public holidays.

AFMA members have reported that regulators in other jurisdictions similarly apply a last calendar day approach to the reporting basis. Against this backdrop, AFMA contends that by allowing an either/or reporting basis, i.e. either last business or last calendar day of the relevant reporting period, a suitable compromise can be reached which will benefit all ADIs with its flexibility, without compromising the accuracy of reporting.

AFMA seeks re-consideration of the reporting basis being, at an ADI's option, either last business or last calendar day of the relevant reporting period.

**1.2 ARF_210_1A LCR – all currencies**

With regard to *16. Other contingent funding obligations*, and specifically:

- *16.4 & 16.5* – Debt securities buy back runoff rates

Guidance is sought on the approach to take in applying the runoff rate, and whether an ADI may follow its own internal risk model.

- *Item 16.6 & 16.8* – Debt securities vis affiliated dealer and non-contractual obligations

An option is provided to ADI to either input runoff rates or '*if applicable, the rate determined by APRA for ADI in column 2'*. Guidance is sought as to the prescribed runoff rate, as currently in the LCR template it is recorded as 0%.

- *Item 35* requires an ADI to report the foreign currency LCR for all currencies where the ADI's total liabilities in that currency (pre-hedging) exceed five per cent of the ADI's total liabilities.

Guidance is sought as to the time basis for assessing whether a currency exposure (pre-hedging) exceeds 5% of total liabilities. Consideration is sought of allowing ADIs to make the assessment annually based on reported balances as at 31 December of the prior calendar year. The timing of the assessment of significant currencies for reporting purposes would then be aligned with the EFS proposals for calculating form-specific reporting thresholds.

Further guidance is sought with regard to the products that are in-scope. For example, are all foreign exchange (FX) swaps included?

**1.3 ARF_210_3_1: Supplementary Contractual Maturity Mismatch - Assets**

- *Item 3.1, 3.2, 4.1 & 4.2* – what is the definition of "offshore" unencumbered securities, for example based on domicile of issuers or location of where the securities are kept in custody? Also, what would fall under "own issued securities"?

Guidance is sought as to the definition of "offshore" unencumbered securities: i.e. is it based on the domicile of issuers or on the location of where the securities are kept in custody. Examples of what may be categorised as "own issued securities" would be welcomed.

- *Item 5.1* Offshore securities purchased under agreements to resell

Guidance is sought as to the rationale behind reporting offshore securities purchased under agreements to resell given that these are off balance sheet items.

- *Item 7* other material contractual cash inflows

Guidance is sought on what may be considered as other material cash flows.

- *Item 10.5 & 10.6*, respectively forecast residential mortgages and RMBS

Further guidance is sought on the methodology to be applied to forecast maturity.

**1.4 ARF_210_3_2: Contractual maturity mismatch - liabilities and capital**

For deposits with minimum notice period and without penalty for early repayment, the instruction requires an ADI to report the balance in 1-7 day column if the notice period is less than 60 days.

Guidance is sought in circumstances where the notice period is greater than 60 days. Should an ADI report based on the notice period, or the tenor of the deposit? Additionally guidance is sought on the rationale for the different treatment between assets and liabilities for balances with no contractual term to maturity, i.e. ADIs are required to report such balances as >10yrs (column 10) for assets and Call/Overnight (column 2) for liabilities.

- *Item 5.* Other material contractual cash outflows

Guidance is sought on what may be considered as other material cash flows.

- *Item 9.* Memo items 9.3 and 9.4 – notice period

Guidance is sought on whether intragroup deposits already reported under 9.1 and 9.2 are excluded from 9.3 and 9.4.

**1.5 ARF_210_4: 3-year funding plan**

Section D *Large liability exposures* captures spot reporting of large exposures

It is noted that this section requires spot reporting of large exposures only. This data is specific to the reporting date, does not relate to planning process and the level of granularity required does not facilitate the creation of the forward looking three year funding plan. If APRA would like details on an ADI's large exposures the reporting requirement may be better aligned to an existing spot balance sheet or liability report.

With regard to:

a) *Item 18 Large liability exposures, and*

b) *Item 19.5 residential mortgages;*

1. Clarification is sought on the disclosure requirement for short selling and derivative liability: Should those products be exempted from the large liability exposure?

2. Clarification is sought over the definition of a group of connected counterparties, in particular, if intercompany or inter-branch liabilities to other branches or head office of foreign ADIs is in scope of the counterparty or a group of connected countries definition for this disclosure purpose.

3. In light of the centralised funding models of many Foreign ADIs have in Australia, AFMA members have indicated that APRA may wish to consider excluding related party exposure from large liability exposures reporting.

4. Clarification is sought as to whether this would include other lending secured by residential mortgages.

**1.6 ARF_210_5: Daily Liquidity Report**

ARF 210.5 is to be completed on the same day (based on data as at close of business the previous day) that the ADI receives a request from APRA to provide ARF 210.5 or the next business day (based on data as at close of business on the date of APRA's request) if APRA's request was made after 12pm.

Satisfying this requirement may be quite difficult for ADIs with offshored accounting and upstream systems, particularly those in European and North American time zones.

Consideration is sought of APRA issuing guidance to address this, potentially by allowing submission of the most recent available data.

- Item 3.1. Net loan principal outflows (contingent and committed outflows over last five business days).

  As described in the instructions, net principal outflows equals originations, advances, redraws and other disbursements minus repayments and other principal collections.

Further guidance is sought on the scale and scope of products to be reported.

- Item 4. Net collateral/margin outflow over last five business days

Further guidance is sought as follows:

The Initial Margin and Variation Margin maintained with ASX are net settled daily. Accordingly, an ADI may not have the detailed breakdown required in the template. Under this circumstance, how should an ADI report net settled margin cash flow?

Where there is no split available to delineate Initial Margin from Variation Margin, how should an ADI report the net collateral position?

### 1.7 Section E: Calculation of the LCR for significant currencies

As proposed, an ADI will be required to report the highest, lowest and mean LCR for all significant currencies, therefore requiring an ADI to produce a daily LCR in each, while also deviating from the statutory compliance requirement of consolidated all-currency LCR reporting.

Given APRA's requirement for foreign ADIs to comply only with an all currency LCR of 40%, with no compliance requirements on AUD or significant currency LCR, the potential exists that the significant currency LCR will not add material value as in many cases it may be 0%. Furthermore, the requirement that an ADI maintain liquid assets consistent with the distribution of its liquidity needs by currency can be fulfilled on a post-hedged basis (based on risk appetite) whereas the significant currency LCR is specific to pre-hedged liabilities. The new reporting form already requires ADIs to report HQLA, outflow and inflows split by the significant currencies defined by APRA, i.e. NZD, USD, GBP, EUR, JPY and RMB. Given this, APRA may wish to consider using these data as its source information and from it deduce the LCR for significant currencies in lieu of collecting it. Alternatively, APRA should consider allowing ADIs to report the month-end position (calendar day) of the significant currency LCR rather than a daily calculation based high / low / mean given that there is no statutory requirement on currency LCR percentage.

AFMA seeks consideration of APRA relying on existing HQLA reporting for significant currencies or alternatively allowing ADIs to report the month-end position of the significant currency LCR rather than a daily calculation based high / low / mean.

### 1.8 Implementation timeline

The rationale for implementing the reporting standard concurrent with the introduction of the revised reporting standard APS210 is well understood. This notwithstanding, foreign ADI members have expressed reservations that, with the final reporting rules likely to be released in calendar quarter three of 2017, and considering the significant changes in the report forms and the granularity of the additional data required, ADIs will not have sufficient time in which to design and test the reporting protocols. This is particularly the case when considered in the light of the significant additional reporting requirements imposed by the new Economic and Financial Statistics data collection, which notably requires balance sheet reporting and asset/liability classifications essentially the same as proposed under ARS 210.0

AFMA seeks APRA's consideration of either extending the timeline within which ADIs must report under ARS 210.0, or staggering the timeline such that ADIs are provided with greater flexibility in how they approach the design and testing phases of the reporting protocols.

## 2 Matters pertaining to other Prudential Standards and relevant to ARS 210.0

### 2.1 Prudential Standard APS 310 Audit and Related Matters

In our view there is limited benefit to data quality from expanding the audit testing scope to data collections under ARS210. All information provided to APRA is subject to process and controls developed by ADIs for the internal review and authorisation of that information. These systems, processes and controls developed by ADIs already ensure the completeness and reliability of the information provided. In addition, the LCR calculation and the ARS210 forms disclosure involve the ADI making a number of estimates and/or assumptions. The implementation of audit testing requirement on those assumptions and estimates will lead to significantly higher audit supervision costs.

AFMA seeks APRA's consideration of allowing flexibility in this regard, proposing that firstly, the calculation be subject to review rather than formal audit and be limited in scope to ARF 210.1A/210.1B (LCR), 210.2 (MLH), 210.6 (NSFR) as applicable, and that secondly, other reports (e.g. 3 year funding plan, daily information requests) should not be the subject of review/or audit testing under APS310.

## 3 Considerations sought on aspects of Prudential Standard APS 210

### 3.1 Foreign ADI Local Operational Capacity Assessment (LOC)

APRA Prudential Standard APS 210 Liquidity effective 1 January 2018 requires an authorised deposit-taking institution to adopt prudent practices in managing its liquidity risks and to maintain an adequate level of liquidity to meet its obligations as they fall due across a wide range of operating circumstances. In particular the ADI is required to maintain a portfolio of liquid assets sufficient in size and quality to enable the institution to withstand a severe liquidity stress, and have a risk management framework to measure, monitor and manage liquidity risk that is commensurate with the nature, scale and complexity of the institution.

The Standard requires a foreign ADI to perform an annual assessment of its local operational capacity (LOC) to liquidate assets and make or receive payments for a minimum of three business days without assistance from staff located outside Australia. Results of the assessment are to be provided to APRA upon request.

It is recognised that a policy driver is a foreign ADI's ability, under a stressed operational scenario, to conduct its operations in a manner which avoids disrupting the domestic payment system either directly or under an agency arrangement, and that in particular the ADI would be in a position to liquidate HQLA assets. It is further recognised that an ADI's ability to make payments in other currencies is an important consideration should missed foreign currency payments cause disruption to the local payments system.

Guidance on what should be considered when undertaking this assessment will greatly assist foreign ADIs in their preparation for the introduction of the new Standard, particularly should the guidance be from an industry-wide perspective and presented as through APRA's issuance of a **Prudential Practice Guide.** This will serve foreign ADIs and the regulator equally by reducing the number of bilateral meetings that may otherwise result.

The following are subjects on which our foreign ADI members seek guidance and or clarification:

***Outsourced operations***

As currently presented in the Standard, a foreign ADI is expected to be able to demonstrate the ability to liquidate assets and make or receive payments for a minimum of three business days without assistance from staff located outside Australia. This expectation however is not aligned to the operational practices of foreign ADIs with APRA-approved outsourced operations. Accordingly for these foreign ADIs, reliance on staff located in other jurisdictions should not prejudice APRAs own assessment of ADI's local operational capacity.

AFMA seeks consideration of APRA issuing guidance clarifying that the literal reading i.e. 'without assistance from staff located outside Australia' in a practical sense does not preclude reliance on staff located in other jurisdictions, and that the ADI's LOC assessment may take this into account.
This guidance may include key considerations of both APRA and RBA as part of the process for maintaining the integrity of the payments system, together with indications of minimum standards for the contingency arrangements backing outsourced operations.

***Assessment timeframe***

It is understood that APRA expects a foreign ADI to have undertaken its initial assessment by 1 January 2018, but that it does not expect that it will review the adequacy of the assessments prior to that start date. It is further understood that the assessment should be performed by the departments involved in the payments process, i.e. Treasury, Cash Management and Operations however that review by the 'second defence' i.e. Ops Risk, Compliance and/or Audit would serve to corroborate the LOC assessment.

Also, in terms of interim arrangements in place between the submission of the self-assessment to APRA, and APRA's review and response, it is understood that APRA does not require any change in arrangements to take place during that time, irrespective of the nature and content of that self-assessment.

Clarification is sought that this remains the current thinking.

***Assessment scope***

AFMA interpretation of the Standard as presented is that the assessment is primarily focussed on Australian currency operations and a foreign ADI's ability to make and receive Australian currency payments including payments associated with the liquidation of assets, and that in undertaking this assessment an ADI need not consider non-material administrative or general accounts payable.

Clarification is sought that this is the appropriate interpretation.

***APRA CPS231 Compliant Arrangements***

A number of member firms have Operational arrangements in place that rely largely or wholly on work performed by staff based outside Australia. In entering into those arrangements those firms have, where required, adhered to the requirements of APRA CPS 231 Outsourcing, including the requirement to consult with APRA prior to entering into a material offshoring arrangement (231.39 basis the version effective 1st July 2017). Given such 'approval' (approval being tacit, more accurately APRA did not raise any objections) members are concerned that a literal application of the LOC clause in CPS210 will have the effect of rescinding such prior approvals.

Clarification is sought that

a) APRA does not intend that 210 should rescind any prior approval to enter into a material offshore arrangements.

b) Where a firm does rely on a CPS 231 compliant offshoring arrangement, the lack of local capability does not preclude that firm from assessing that its LOC is adequate, after taking the approved arrangements into account.

### 3.2 RSF factor applicable to open reverse repo transactions

***Context***

The Net Stable Funding Ratio (NSFR) requires so-designated ADIs to maintain a stable funding profile in relation to the composition of their assets and off-balance sheet activities, and is intended amongst other things to limit overreliance on short-term wholesale funding.

Australian NSFR banks are very active in Australia's repo market, and have expressed concern that asymmetrical treatment of open repo in terms of the ASF and RFS factors has the potential to disrupt the market by way of significantly higher costs absent recognition in particular of what is the practical and widely accepted maturity profile of an open reverse repo in this marketplace.

In its February 2017 re-stated NSFR FAQ, BIS clarified the treatment of reverse repo as per new section 5.1., i.e. that a 10% RSF factor will apply for the amount receivable by a bank under a reverse repo transaction secured by HQLA1 assets provided the residual maturity of the transaction is less than six months. Its supporting guidance continues to be that *'In the case of a non-maturity reverse repo, they should be assigned as RSF=100% (to continue over the one-year term), unless banks can demonstrate to supervisors that the non-maturity (open) reverse repo would effectively mature in a different period.'*

APRA Prudential Standard APS 210 Liquidity effective 1 January 2018 similarly states that *'for a non-maturity reverse repo, an RSF of 100 per cent applies, unless an ADI is able to demonstrate to APRA's satisfaction that it would effectively have a different maturity period'*[1].

AFMA maintains that the Australian repo marketplace does not expect open reverse repo to continue over a one year term, or in any practical sense beyond six months, particularly from the perspective of a banks inability for any reason to terminate the transaction. AFMA proposes that there are mitigating factors which may be considered by APRA which would enable it to provide guidance to NSFR banks with regard to it assigning a 10% RSF factor under an open reverse repo, provided the transaction is secured by HQLA1 assets. These mitigating factors follow.

***Institutional nature of Australia's repo market***

In aggregate, HQLA1 assets collateralised 93% of local interbank repo transactions, 66% of transactions with the RBA, 53% of transactions with non-residents and 85% of transactions with Other Parties. In aggregate, excluding transactions with Other Parties, HQLA1 assets collateralised 83% of transactions between large financial institutions increasing to 91% when considered in the light that at least 50% of Other Parties are likely also to be large financial institutions.

It is therefore reasonable to expect that large financial institutions, which constitute the overwhelming majority of Australian repo participants, will engage the repo market in a manner which fully recognises market conventions with regard to the effective maturity of an open transaction, i.e. that such transactions can be terminated at will by either party and settled on the next practical business day.

[1] Footnote #28 to Banking (prudential standard) determination No. 1 of 2017

***AOFM interpretation of what constitutes the effective maturity of open repo***

AOFM defines what constitutes the effective maturity of an open repo under the terms of its Securities Lending Facility and available to eligible counterparties[2], i.e.:

> *'An open term securities lending transaction is automatically rolled on the same terms at 5:45 pm/7:45 pm AEDT each business day unless either the RBA or the counterparty advise otherwise prior to this time. For RITS members who do not operate an ES account, an open term securities lending transaction is automatically rolled on the same terms at 3:45 pm each business day unless either the RBA or the counterparty advise otherwise prior to this time. The maturity date can be the same day the advice is received.'*

With this definition, the large institutional market has clear and unequivocal guidance that when dealing with the AOFM, an open repo may be terminated on any given business day, and which by extension means that the termination will be concluded at the earliest practical time, i.e. generally either the next or following (T+1, T+2) business day.

***AFMA Conventions definition of what constitutes the effective maturity of open repo***

AFMA's Repo Conventions define the effective maturity of at-call/open repos; specifically that:

> *'At call/open specific collateral repos are automatically rolled at 9:30am on the business day preceding maturity (trade date -1 basis) unless otherwise advised by either counterparty on the business day preceding maturity. Market standard is to notify prior to 9:30am all trade terminations T+1.*
> *GC open repos are automatically rolled at 11:00am unless otherwise advised by either counterparty'*

As is the case with the AOFM definition, the large institutional market has further clear and unequivocal guidance that when dealing in the Australian repo markets, counterparties to an open repo transaction may terminate the transaction on any given business day, and which by extension also means that the termination will be concluded at the earliest practical time, i.e. generally either the next or following (T+1, T+2) business day.

***Event of default provisions in repo documentation***

It is recognised that a circumstance could eventuate whereby a party in an open repo transaction failed to settle upon termination of the contract by the other party. This risk is mitigated by event of default provisions within GMRA and other documentation, which include settlement failure as an event of default and the remedies then available for a party to be compensated.

***Existing and emerging precedent in other jurisdictions***

In large institutional markets globally, it is widely recognised that an open transaction may be terminated on the current business day, with settlement thereafter to occur on the next practical business day. Evidencing this, the International Capital Markets Association (ICMA) and its European Repo Council define an open repo as:

> *'An open repo (also known as on demand repo) is a repurchase agreement that is agreed without fixing the maturity date. Instead, the repo can be terminated on any*

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[2] Any member of the Reserve Bank Information and Transfer System (RITS) eligible to participate in the Reserve Bank's domestic market operations is able to access the securities lending facility

*day in the future by either party, provided they give notice before an agreed daily deadline.*

*Until an open repo is terminated, it automatically rolls over each day. Interest accrues daily but is not compounded (i.e. interest is not earned each day on interest accrued over previous days). Where parties have open repos outstanding between themselves all the time, accumulated interest is typically paid off every month. The initial repo rate on an open transaction will be close to the overnight repo rate, but it will not subsequently change until the parties agree to re-set the rate. Open repo is used to invest cash or finance assets where the parties are not sure how long they will need to do so.'*

In AFMA's 28 October 2016 submission to APRA on *Draft Prudential Standard 210 & Prudential Practice Guide APG 210 – Liquidity* we drew attention to draft US rules[3] which have recognised the validity of aligning the maturity treatment of the funding and asset side of an open repo, i.e. Paragraph .101 *Determining maturity,* subparagraph (d) provides that, in relation to the ASF amount and NSF amount, a bank shall assume *"With respect to an NSFR liability or asset that has an open maturity, the NSFR liability or asset matures on the first calendar day after the calculation date"*

Viewed in this light, we believe thatin the large institutional markets, open reverse repo transactions may be terminated on any business day and that settlement of the termination will proceed without incident.

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| AFMA seeks APRA's consideration of it communicating to repo market participants, by way of either its response to submissions to *Reporting Standard ARS 210.0 Liquidity* or by other means that it acknowledge the validity of the arguments as presented, and that an open or non-maturity reverse repo may be deemed to have an effective residual maturity of not more than six months given the parties unequivocal right to terminate at any time.<br>It is accepted that certain controls should exist within the operations of repo market participants to ensure that this effective residual maturity is controlled by way of operational oversight, and that relationship pressures cannot influence any decision to further extend the term beyond six months. AFMA contends that market participants engaged in open reverse repo transactions should be able to confidently assign a 10% RSF factor in circumstances where:<br>1. Operational controls are in place to flag any open reverse repo which extends beyond 170 days, and that termination will be mandatory prior to it extending to 180 days;<br>2. Oversight of control and the exercise of the termination is a responsibility maintained remotely from any of the relationship, sales or trading divisions of the organisation. |

## 3.3 Treatment of Home Office Support within the LCR Calculation

It is understood that the amount of committed home office support is to be reported as a cash inflow (and not as HQLA1) in the LCR calculation.

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| Confirmation is sought that this is the appropriate interpretation. |

## 3.4 Potential for recognition of HQLA Assets

[3] US Government Publishing Office, 12 CFR Part 329 Net Stable Funding Ratio: Liquidity Risk Measurement Standards and Disclosure Requirements; Proposed Rule Federal Register, Vol. 81, No. 105, June 1, 2016, Proposed Rules, Subpart K para.101(d)

The Standard now provides considerable detail around HQLA2 notwithstanding that no asset class is assigned, it being understood that there is no immediate intent to recognise these in the calculation of the LCR notwithstanding allowance of certain Australian-listed equities within the NSFR calculation.

AFMA members welcome the opportunity to table this for further discussion.

## Conclusion

AFMA ADI members seek APRA’s feedback and guidance on these issues, and to the extent possible would welcome this to be provided in the form of a Prudential Practice Guide or similar communication, for example, as a *Frequently Asked Questions* document.

AFMA members are happy to provide further feedback on any of the above issues.

Yours sincerely

**Dr Stephen Kirchner**
**Economist**