

## Post-RCAP follow-up report: Australia

### Reference RCAP report: Assessment of Basel III capital regulations in Australia, March 2014

Status as of: 31 December 2015

This follow-up report provides an overview of where the jurisdiction has taken, or plans to take, further actions to address findings raised in the RCAP assessment report. The report is based on self-reporting and the reported actions have not been reviewed by the Basel Committee.

#### 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)

(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 owned by members. APRA has indicated that work is still being finalised on	<i>Prudential Standard APS 111 Capital Adequacy: Measurement of Capital (APS 111), paragraph 19, Attachments B and K</i>	APRA has amended its prudential requirements to include “mutual equity interests” that effectively apply the criteria for ordinary (common) shares to mutually owned ADIs.

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

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	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 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)	APRA is revising its securitisation framework and, under the measures currently subject to consultation, proposes to update the definition in paragraph 12(s) to remove the reference to warehouse SPVs with only one tranche.

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Basel II paragraphs 569 and 570	Pursuant to Basel II paragraph 569, only third-party investors, as opposed to banks that serve as originators, may recognise external credit assessments that are equivalent to BB+ to BB- for risk-weighting purposes of securitisation exposures. According to Basel II paragraph 570, originating banks must deduct all retained securitisation exposures rated below investment grade (ie BBB-). Basel III paragraph 90 introduced a 1250% risk weight instead of deduction for securitisation exposures. APS 120 does not provide this treatment for originating ADIs. Thus, originating ADIs are also allowed to risk-weight securitisation exposures rated BB+ to BB- at 350% instead of the 1250% as detailed in Basel III paragraph 90.	APS 120 Attachment C paragraphs 6 and 36	APRA is revising its securitisation framework and, under the measures currently subject to consultation, proposes to require deduction of all securitisation exposures rated below investment grade regardless of originator.
Basel II paragraph 590	Pursuant to Basel II paragraph 590 an originating bank is required to hold capital against all or a portion of the investors' interest when: (a) It sells exposures into a structure that contains an early amortisation feature; and (b) The exposures sold are of a revolving nature. These involve exposures where the borrower is permitted to vary the drawn amount and repayments within an agreed limit under a line of credit (eg credit card receivables and corporate loan commitments). Under APS 120 paragraph 12(r), revolving exposures are exposures arising from revolving (that is redrawable) facilities, other than exposures in the nature of redrawable home loans where the amounts likely to be redrawn in any collection period are expected to be immaterial relative to the size of the pool. Such an exception for	APS 120 paragraph 11(r)	APRA is revising its securitisation framework and, under the measures currently subject to consultation, proposes to update the definition of a revolving securitisation.

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	redrawable home loans is not provided in Basel II paragraph 590(b).		
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.	N/A	APRA is revising its securitisation framework and, under the measures currently subject to consultation, proposes to remove the IRB approach for securitisation exposures.
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.	N/A	APRA is revising its securitisation framework and, under the measures currently subject to consultation, proposes to remove the IRB approach for securitisation exposures.
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	APRA is revising its securitisation framework and, under the measures currently subject to consultation, proposes to remove the IRB approach for securitisation exposures.

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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</i> (CPS 220), which will come into place in January 2015, incorporates the Basel II qualifying requirements.	CPS 220 paragraphs 13, 21-27	CPS 220 came into effect on 1 January 2015.
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 now 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 now 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 now 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 (eg 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 intends to respond to this issue after the completion of the Basel Committee's current work relating to the IRB 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 notes that the treatment of real estate under the standardised approach to credit risk is subject to consultation by the Basel Committee and will review its approach once this, and the Basel Committee's current work relating to the IRB framework, is completed; and
- 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, securitisation and reducing risk-weight variability. Given that the Basel framework in these areas may change, APRA has deferred making what in most instances are minor changes pending the outcome of these reviews. Under the legislative framework in which APRA's prudential standards are made, even minor changes require considerable resources, including industry consultation, to bring about.

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

- *Prudential Standard APS 112 Capital Adequacy: Standardised Approach to Credit Risk* inadvertently omitted the requirement whereby no claim on an unrated bank may receive a risk weight lower than that applied to claims on its sovereign of incorporation (Basel II paragraph 60);

- *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).

Two additional items listed in Annex 6 have yet to be resolved because, due to competing priorities, APRA has not yet commenced a review of APS 111, now expected in 2016. These items related to the definition of capital 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.