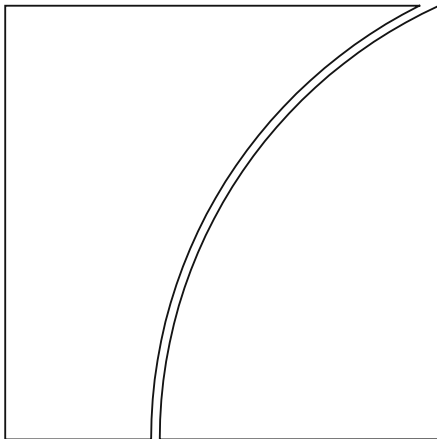


# Basel Committee on Banking Supervision



## Regulatory Consistency Assessment Programme (RCAP)

### Assessment of Basel large exposures regulations – Australia

July 2019



BANK FOR INTERNATIONAL SETTLEMENTS

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## Glossary

ADI	Authorised Deposit-Taking Institution
APS	ADI Prudential Standard
APRA	Australian Prudential Regulation Authority
BCBS	Basel Committee on Banking Supervision
BIS	Bank for International Settlements
C	Compliant (grade)
CCF	Credit Conversion Factor
CEM	Current Exposure Method
CFR	Council of Financial Regulators
D-SIB	Domestic systemically important bank
FAQs	Frequently Asked Questions
GRE	Government-Related Entity
G-SIB	Global systemically important bank
HQLA	High-quality liquid asset
IRB	Internal ratings-based approach
LC	Largely compliant (grade)
LEX	Large exposures
MNC	Materially non-compliant (grade)
NC	Non-compliant (grade)
NOHC	Non-Operating Holding Company
RCAP	Regulatory Consistency Assessment Programme
RMBS	Residential mortgage-backed security
SA-CCR	Standardised Approach for Measuring Counterparty Credit Risk Exposures
SIG	Supervision and Implementation Group

## Preface

The Basel Committee on Banking Supervision (BCBS) places 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 fully, consistently and in a timely manner by all member jurisdictions. The Committee established the Regulatory Consistency Assessment Programme (RCAP) to monitor, assess and evaluate its members' implementation of the Basel framework.

This report presents the findings of an RCAP Assessment Team on the domestic adoption of the Basel large exposures (LEX) framework in Australia. The assessment focused on the completeness and consistency of the domestic regulations in force on 31 March 2019, as applied to all authorised deposit-taking institutions (ADIs), with the Basel large exposures framework. Issues related to prudential outcomes, the resilience of the banking system or supervisory effectiveness of the Australian authorities were not in the scope of this assessment. The assessment relied on regulations and other information and explanations provided by APRA and ultimately reflects the view of the Basel Committee.

The RCAP Assessment Team was led by Arthur Yuen, Deputy Chief Executive, Hong Kong Monetary Authority. The team comprised four technical experts from Georgia, Japan, the Philippines, and the United States (see Annex 1). The main counterpart for the assessment was the Australian Prudential Regulation Authority (APRA). The work was coordinated by the Basel Committee Secretariat with support from staff from the Team Leader's organisation.

The assessment began in October 2018 and comprised three phases: (i) self-assessment by the assessed jurisdiction's authorities; (ii) an assessment phase (November 2018 to March 2019), including an on-site assessment involving discussions with APRA and other stakeholders; and (iii) a review phase (April 2019 to May 2019), including a technical review of the Assessment Team's findings by a separate RCAP Review Team, the Committee's Supervision and Implementation Group, the RCAP Peer Review Board and the Basel Committee. More information on the RCAP assessment process is available on the Committee's website.<sup>1</sup>

The RCAP Assessment Team acknowledges the cooperation received from APRA counterparts throughout the assessment process. In particular, the team thanks the staff at APRA for playing an instrumental role in coordinating the assessment exercise.

<sup>1</sup> See [www.bis.org/bcbs/implementation.htm](http://www.bis.org/bcbs/implementation.htm).

## Executive summary

The Australian framework for LEX requirements was issued in December 2017 through the publication of the revised Prudential Standard APS 221 and the Reporting Standard ARS 221. The requirements came into effect in January 2019, consistently with the internationally agreed timeline except for some elements. APRA's LEX standard is applicable to all locally incorporated banks on a consolidated basis.

As of 31 March 2019, the LEX regulation in Australia is overall assessed as compliant with the Basel LEX standard. This is the highest possible grade. Each individual component is also assessed as compliant. The Assessment Team noted some non-material deviations such as the treatment regarding entities connected with sovereigns.

The Basel framework allows entities not to constitute a group of connected counterparties where the entities are controlled by or economically dependent on an entity that falls within the scope of the sovereign exemption and "are otherwise not connected". APRA's rule does not require government-related entities (GREs) to be aggregated even if the GREs are connected with each other since the phrase "and are otherwise not connected" is missing. The Assessment Team considers this finding non-material, as APRA confirmed that this more lenient treatment only applies to Australian GREs to which the covered internationally active banks' current exposures would not exceed 10% of Tier 1 capital even when assuming that all GREs are connected. Furthermore, these exposures have been in a stable to declining trajectory over the last three years.

The Assessment Team identified two points where further guidance from the Basel Committee is sought (Annex 4).

APRA's LEX regulation is super-equivalent to the Basel LEX standard in several areas: application to all domestic banks in addition to the internationally active banks, inclusion of the exposures to the foreign governments, 100% CCF for the off-balance commitments, additional limits for D-SIB's exposure to other D-SIBs, and 100% exposure for all covered bonds. The stricter rules have not been taken into account as mitigants for the overall or component-level assessment of compliance.

## Response from APRA

APRA acknowledges the efforts taken by the RCAP Assessment Team to understand and evaluate Australia's large exposure requirements. We appreciate the level of engagement made by the Assessment Team when comparing our requirements against the Basel large exposures framework and we thank the RCAP Assessment Team for the rigour in their assessment process.

We welcome the overall rating of "compliant". In developing large exposure requirements, APRA tailored the Basel large exposures framework to Australian conditions where necessary, and incorporated feedback from industry consultation; we acknowledge the RCAP Assessment Team's reflection of these features in its assessment.

APRA will continue to ensure the effective operation of large exposure requirements in Australia through its supervisory processes.



# 1 Assessment context

## 1.1 Status of implementation of the large exposures framework

To implement the Basel Committee on Banking Supervision's (BCBS) Standards (Supervisory framework for measuring and controlling large exposures, released in April 2014), the Australian Prudential Regulation Authority (APRA) finalised, after an initial consultation phase, Prudential Standard APS 221 and Reporting Standard ARS 221 in December 2017. Both standards were officially approved in August 2018. Most of the requirements have been in force since January 2019; however, some elements will be implemented in July 2019 due to a slightly delayed implementation of the SA-CCR framework. Furthermore, there is a transition period for applying the BCBS requirements to connected counterparties as well as the look-through approach and additional risk factor considerations for structures from January 2020 onward. APS 221 applies to all ADIs in Australia, including small and medium-sized ADIs that are not internationally active.

## 1.2 Regulatory system

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). APRA's core mission is "to establish and enforce prudential standards and practices designed to ensure that, under all reasonable circumstances, financial promises made by the institutions APRA supervises are met within a stable, efficient and competitive financial system". APRA has statutory powers to regulate and intervene in the operations of ADIs, including the power to revoke a supervised entity's authorisation if it fails to meet statutory requirements or prudential standards; make, apply and enforce prudential standards; collect information, conduct onsite examinations and require third-party audits; and act in certain circumstances to protect depositors and to maintain the stability of the financial system by investigating, giving directions and assuming control of ADIs in difficulty. APRA can appoint a statutory manager to assume full control of the ADI. APRA has developed a regulatory framework for ADIs and non-operating holding companies (NOHCs) based on the banking supervision principles published by the Basel Committee. APRA also acts under the Financial Sector (Collection of Data) Act 2001 as the national statistical agency for the financial sector. ADIs must provide financial information data in regular standardised reports to APRA.

## 1.3 Structure of the banking sector

The Australian banking sector is dominated by four major banks which provide a full range of institutional, commercial and retail banking services: Australia and New Zealand Banking Group Limited, Commonwealth Bank of Australia, National Australia Bank Limited and Westpac Banking Corporation. There are also several smaller banks, building societies and credit unions operating in particular sectors or regions.

APRA has determined that the "big four" banks (see above) are domestic systemically important banks (D-SIBs). None of the Australian incorporated banks meet the criteria for classification as a global systemically important bank (G-SIB). These four banks as well as Macquarie Bank are considered to be internationally active. There is no state-owned bank in Australia. In evaluating the materiality of its findings,

the RCAP Assessment Team focused on the five largest banks in Australia. Together, these banks account for about 80% of the banking sector's total assets. Annex 3 provides further information on the banking system in Australia.

## 1.4 Scope of the assessment

The Assessment Team considered the large exposure limits applicable to all ADIs as of 31 March 2019. The assessment had two dimensions:

- A comparison of domestic regulations with the Basel large exposures framework to ascertain that all the required provisions have been adopted (*completeness* of the regulations); and
- Whether there are any differences in substance between the domestic regulations and the Basel large exposures framework and, if so, their significance (*consistency* of the regulations).

In its assessment, the RCAP Assessment Team considered all binding documents that effectively implement the Basel large exposures framework in Australia. Annex 2 lists the Basel standards used as the basis for the assessment. The assessment did not evaluate the adequacy of liquidity or the resilience of the banking system in Australia or the supervisory effectiveness of APRA.

As set out in the RCAP methodology, the Assessment Team evaluated the materiality and potential materiality of identified deviations between the Basel large exposures framework and the local regulations. The quantification was limited to a sample of banks. In addition, the Assessment Team reviewed the non-quantifiable aspects of identified deviations and applied expert judgment as to whether the domestic regulations meet the Basel framework in letter and in spirit. The materiality analysis is summarised in Annex 3, which also lists the sample of banks.

The Assessment Team noted that in some areas the assessed jurisdiction's rules go beyond the minimum Basel standards. Although these elements (listed in Annex 7) provide for a more rigorous implementation of the Basel framework, they have not been taken into account for the assessment of compliance.

The outcome of the assessment is summarised using a four-grade scale, both at the level of each of the three key components of the Basel large exposures framework and the overall assessment of compliance. The four grades are compliant, largely compliant, materially non-compliant and non-compliant.

## 2 Assessment findings

### 2.1 Assessment grades and summary of findings

Overall, the Assessment Team finds the implementation of the large exposures framework in Australia to be compliant with the Basel standards. This grade is based on the materiality assessment (summarised in Annex 3).

## Assessment grades

Table 1

Component of the Basel LEX framework	Grade
Overall grade	C
Scope and definitions	C
Minimum requirements and transitional arrangements	C
Value of exposures	C

Assessment scale: C (compliant), LC (largely compliant), MNC (materially non-compliant) and NC (non-compliant).

### 2.1.1 Scope and definitions

APRA's regulation on the scope and definition requirements is assessed to be compliant with the Basel standard. The Assessment Team did not find any differences between APRA's LEX regulation and the Basel LEX framework with regard to the scope and definitions.

### 2.1.2 Minimum requirements and transitional arrangements

APRA's regulation on the minimum requirements and transitional arrangements is assessed to be compliant with the Basel standard. The Assessment Team observed the following differences between APRA's LEX regulation and the Basel LEX framework with regard to the minimum requirements and transitional arrangements.

APRA's rule allows an ADI to exceed the limits if it obtains a prior approval from APRA. Unlike the BCBS standards, it does not limit itself to stressed circumstances or interbank exposures. However, APRA confirmed that such cases are treated as exceptional and strictly monitored by APRA.

APRA has set transitional arrangements for groups of connected counterparties, identification of additional risks, and structured vehicles until 31 December 2019. It has also set transitional arrangements for counterparty credit risk exposures to be measured using SA-CCR until July 2019.

APRA has no rule for a G-SIB's exposure to another G-SIB, as there are currently no G-SIBs in Australia.

### 2.1.3 Value of exposures

APRA's regulation on the value of exposure requirements is assessed to be compliant with the Basel large exposures standards, with the following four areas of non-material deviations:

- exposures to an ADI that is part of an industry liquidity-supporting arrangement are exempted from the LEX framework;
- aggregation of exposures to government-related entities (GREs) is not required according to APRA's rule, even if these entities are connected;
- APRA's rule limits the look-through requirement relating to exposures to structured vehicles to only a vehicle which holds non-retail assets; and
- APRA's rule requires an ADI to add its exposures to a structured vehicle to other exposures to that third party if there is a "material" risk caused by the default of the third party. "Material risk" is determined by ADIs in accordance with their risk management process and procedures.

In addition, even though it is expected that every internationally active ADI will use SA-CCR after July 2019, using SA-CCR is not a mandatory requirement for ADIs using the standardised approach. However, all internationally active ADIs are using the IRB approach at this moment and APRA has the power to require standardised ADIs to use SA-CCR.

Finally, APRA does not explicitly forbid regulatory arbitrage in relation to the application of the look-through arrangement. However, under its principles-based regulatory regime, APRA confirmed that ADI's are generally aware that regulatory arbitrage will not be tolerated by the supervisor.

## 2.2 Detailed assessment findings

### 2.2.1 Scope and definitions

This component is assessed to be compliant with the Basel framework. No findings were identified.

### 2.2.2 Minimum requirements and transitional arrangements

This component is assessed to be compliant with the Basel framework. No findings were identified.

### 2.2.3 Value of exposures

This component is assessed to be compliant with the Basel framework. Four findings were identified.

Section grade	Compliant
Basel paragraph number	13: scope of counterparties and exemptions
Reference in the domestic regulation	APS 221 paragraph 18(j)
Finding	The Basel framework provides some limited exemptions to the LEX framework. In addition to the Basel exemptions, APRA exempts exposures to an ADI that is part of an industry liquidity-supporting arrangement. This arrangement has been certified by APRA. APRA explained that this provision was introduced to support the liquidity needs of small credit unions in times of stress and that it has no impact on the internationally active banks. The list of members of this arrangement is available online. <sup>2</sup>
Materiality	Not material
Basel paragraph number	62: entities connected with sovereigns
Reference in the domestic regulation	APS 221 paragraph 24
Finding	The Basel framework allows entities not to constitute a group of connected counterparties where the entities are controlled by, or economically dependent on, an entity that falls within the scope of the sovereign exemption and "are otherwise not connected". APRA's rule does not require government-related entities (GREs) to be aggregated even if the GREs are connected with each other since the phrase "and are otherwise not connected" is missing. Therefore, if companies X and Y are controlled by the government, and company X is controlled by company Y, for example, APRA's rule does not require a bank to consider companies X and Y as one group since they are controlled by the same government. This allows a bank to disregard the relationship between companies X and Y while the BCBS rules require a bank to consider company X and Y as one group since they are connected. APRA explained that, while with respect to foreign GREs it would require aggregation of exposures of connected entities in accordance with the BCBS standards, this rule will not be applied in Australia to allow for domestic bank financing of large GRE infrastructure projects in the future. The Assessment Team considers this finding non-material since the covered internationally active banks' current exposures towards Australian GREs would be below 10% of Tier 1 capital even when assuming that all GREs are connected. Furthermore, these exposures are stable or in tendency feature a declining trajectory over the last three years and are unlikely to rise above the limit in the foreseeable future even when

<sup>2</sup> See <http://cufss.com.au/> and <http://cufss.com.au/pdf/CUFSS%20MEMBERS.pdf>.

	considering the impact of the infrastructure projects. Note that the deviation is non-material within the current assessment horizon, but this area may warrant consideration in the future.
Materiality	Not material
Basel paragraph number	74: determination of the relevant counterparties to be considered
Reference in the domestic regulation	APS 221 Attachment A paragraph 22
Finding	The Basel framework requires a bank to look through structures to identify the underlying assets and add exposures, subject to a 0.25% threshold. APRA's rule limits the look-through requirement to only non-retail assets to reduce the burden, which has no impact on internationally active ADIs. APRA and the major Australian banks explained to the Assessment Team that retail exposures within a structured vehicle would fall below the 0.25% threshold given the size of the capital bases of internationally active banks, and therefore would not qualify for aggregation in any event. Therefore, requiring the look-through approach for structures that consist only of retail exposures is not necessary.
Materiality	Not material
Basel paragraph number	81: identification of additional risks
Reference in the domestic regulation	APS 221 Attachment A paragraph 31
Finding	The Basel framework requires a bank to add its exposures to a structured vehicle associated with a third party to other exposures it has to that third party where default risk arises for the structured vehicle in the event of that third party's default. APRA's rule requires an ADI to add its exposures to a structured vehicle associated with a third party deemed to contribute an additional risk factor to other exposures to that third party, if there is a "material" risk caused by the default of the third party itself or a default on a direct exposure it has to the ADI. According to APRA's principles-based approach, ADIs are required to determine whether additional risks are considered material enough to aggregate exposures to structured vehicles with exposures to the associated third party. Based on discussions with APRA, ADI's practices are monitored and the exposures concerned are not material.
Materiality	Not material

## 2.3 Observations on the implementation of the large exposures framework in Australia

The following observations highlight certain special features of the regulatory implementation of the Basel large exposures framework in Australia. These are presented to provide additional context and information. Observations are considered compliant with the Basel standards and do not have a bearing on the assessment outcome.

### 2.3.1 Minimum requirements and transitional arrangements

Basel paragraph number	66: interbank exposures
Reference in the domestic regulation	APS 221 paragraph 36
Observation	The Basel framework allows supervisors to accept a breach of an "interbank limit" "ex post in stressed circumstances" in order to help ensure stability in the interbank market. APRA's rule allows an ADI to exceed the limits if it obtains a prior approval from APRA. It does not limit this to stressed circumstances or a breach of an interbank limit specifically. However, based on discussions with APRA such cases will be treated as exceptional and strictly monitored.

Basel paragraph number	90: rules for G-SIBs
Reference in the domestic regulation	Nil
Observation	<p>The Basel framework sets a 15% limit applied to a G-SIB's exposure to another G-SIB. APRA has no rules for G-SIBs, as it has no G-SIBs. Should an APRA-regulated ADI be deemed to be a G-SIB, APRA would act to implement the Basel large exposure limit for G-SIBs. In the first instance, were there a need to expedite the process, this could be achieved through paragraph 31 of APS 221. Paragraph 31 allows APRA to set specific limits on an ADI's exposures to particular counterparties, groups of connected counterparties, industry sectors, countries or asset classes, including property holdings and any other investments, having regard to the ADI's individual circumstances. To establish the change on a permanent basis, APRA would then undertake further consultation.</p>
Basel paragraph number	93: implementation date
Reference in the domestic regulation	APS 221 paragraph 20, Attachment B, Attachment C
Observation	<p>The Basel standards note that all aspects of the large exposures framework must be implemented in full by January 2019.</p> <p>APRA has provided transitional arrangements for the implementation of rules for groups of connected counterparties, identification of additional risks, and structured vehicles until 31 December 2019.</p> <p>APRA has also provided transitional arrangements for counterparty credit risk exposures, which is to be measured using the current method prior to the commencement of APS 180 SA-CCR requirements on 1 July 2019.</p>

### 2.3.2 Value of exposures

Basel paragraph number	33: banking book and trading book OTC derivatives
Reference in the domestic regulation	APS 221 Attachment A paragraph 1(b) APS 180 paragraphs 10–12
Observation	<p>The Basel standard notes that counterparty credit risk must be measured by the standardised approach for counterparty credit risk (SA-CCR).</p> <p>APRA's rule requires only IRB ADIs to use SA-CCR and allows standardised ADIs to use the modified current exposure method (CEM). However, first, APRA may require a standardised ADI to use SA-CCR. Second, all internationally active banks are expected to use SA-CCR from July 2019 onwards, since they are all IRB ADIs at this moment. In the event that an ADI has its IRB accreditation revoked, APRA confirmed that it would require the ADI to use SA-CCR.</p>
Basel paragraph number	73/76: determination of the relevant counterparties to be considered
Reference in the domestic regulation	APS 221 Attachment A paragraphs 21–27
Observation	<p>The Basel framework requires a bank to look through structures to identify the underlying assets and assign the total exposure amount of its investment to the structure if the bank's exposure amount to each underlying asset of the structure is below 0.25%.</p> <p>APRA confirmed that paragraphs 21–27 in Attachment A of APS 221 cover all exposures arising from structured vehicles – including from those structures that consist only of retail exposures – under the large exposures reporting and limit requirements.</p> <p>However, the Assessment Team pointed out to APRA that, if paragraphs 21 and 23–27 apply to all vehicles (as APRA explained), paragraphs 24 and 22 may contradict each other in the presence of vehicles which consist only of retail assets. In particular, paragraph 24 requires an ADI to use the look-through approach if an exposure value of a structured vehicle is greater than or equal to 0.25%, while paragraph 22 exempts the</p>

	<p>look-through approach for structures that consist only of retail assets regardless of the size. If paragraph 24 (the look-through approach) does not apply to vehicles which only hold retail assets, it follows that paragraph 23 (assigning exposure values to a structure vehicle) may not apply either.</p> <p>Based on the above reasoning, there may be a possibility that ADIs interpret the rule as not requiring them to assign/report exposures values to a structured vehicle itself in the case that it holds only retail assets.</p>
Basel paragraph number	76: regulatory arbitrage
Reference in the domestic regulation	Nil
Observation	<p>The Basel framework requires a bank to be able to demonstrate that regulatory arbitrage has not influenced the decision whether to look through or not in order to prevent a bank from circumventing the limit by investing in several individually immaterial transactions.</p> <p>APRA LEX regulations do not include the Basel language regarding regulatory arbitrage. However, APRA confirmed that, under its principles-based regulatory regime, this Basel paragraph is implicitly covered and enforced in practice (i) by ADIs having to follow the intention of regulations, and (ii) by APRA's on-site examinations/verifications. In particular, APRA explained that explicitly preventing regulatory arbitrage in the large exposures regulations would be inconsistent with its other regulations, which do not include this specific language. APRA provided quotations from its regulatory documents and communications to demonstrate that regulatory arbitrage violates the intention of its regulations and is not permitted.</p>

## Annexes

### Annex 1: RCAP Assessment Team and Review Team

#### Assessment Team Leader

Mr Arthur Yuen                                  Hong Kong Monetary Authority

#### Assessment Team members

Mr Alvin Gamat                                  Bangko Sentral ng Pilipinas  
Mr James Weinberger                          US Office of the Comptroller of the Currency  
Ms Teona Kontridze                              National Bank of Georgia  
Ms Rie Asakura                                    Japan Financial Services Agency

#### Supporting members

Mr Marcel Bluhm                                  Hong Kong Monetary Authority  
Mr Thomas Wong                                  Hong Kong Monetary Authority  
Mr Mark Pocock                                   Basel Committee Secretariat  
Mr Olivier Prato                                   Basel Committee Secretariat

#### Review Team members

Mr Toshio Tsuiki                                  Basel Committee Secretariat  
Mr Simon Dixon                                   Bank of England, Prudential Regulatory Authority  
Ms Anne Lécuyer                                   European Central Bank, Single Supervisory Mechanism  
Mr Tuang Lee Lim                                  Monetary Authority of Singapore



## Annex 2: List of Basel standards and implementing regulations issued by APRA

The following Basel standards were used as the basis of this RCAP assessment:

- *Supervisory framework for measuring and controlling large exposures*, April 2014
- *Frequently asked questions on the supervisory framework for measuring and controlling large exposures*, September 2016

Table A.1 lists the regulations issued by APRA to implement the large exposures framework in Australia. Previous RCAP assessments of Australia’s implementation of the Basel standards considered the binding nature of regulatory documents in Australia.<sup>3</sup> This RCAP Assessment Team did not repeat that assessment, but instead relied on the previous assessments’ findings. Those assessments concluded that the types of instrument described in Table A.1 could be considered as binding on banks and supervisors for the purposes of an RCAP assessment.

Domestic regulations	Type, version and date
Banking Act	The Banking Act (1959) in force on 30 November 2018
Prudential Standard APS 180 Capital Adequacy: Counterparty Credit Risk	Prudential Standard APS 180 Capital Adequacy: Counterparty Credit Risk issued in April 2018
Prudential Standard APS 221 Large Exposures	Prudential Standard APS 221 Large Exposures issued in December 2017 (signed in August 2018)
Reporting Standard ARS 221.0 Large Exposures	Reporting Standard ARS 221.0 Large Exposures issued in December 2017 (signed in August 2018)

Source: APRA.

<sup>3</sup> See Annex 5 of the BCBS RCAP-LCR report for Australia, [www.bis.org/bcbs/publ/d419.pdf](http://www.bis.org/bcbs/publ/d419.pdf).

## Annex 3: Materiality assessment

The outcome of the RCAP assessment is based on the materiality of the findings described in Section 2.2 and summarised in Table A.2. Assessment Teams evaluate the materiality of findings quantitatively where possible, or using expert judgment when the impact cannot be quantified.

The materiality assessment for quantifiable gaps is based on the cumulative impact of the identified deviations on the reported large exposures of banks in the RCAP sample. These banks are listed in Table A.3.

Number of deviations by component				Table A.2
Component	Not material	Potentially material	Material	
Scope and definitions	0	0	0	
Minimum requirements and transitional arrangements	0	0	0	
Value of exposures	4	0	0	

RCAP sample banks		Table A.3
Banking group	Share of banks' assets in the total assets of the Australian banking system (per cent)	
Bank 1	19.6%	
Bank 2	20.2%	
Bank 3	18.4%	
Bank 4	18.5%	
Bank 5	4.3%	
Total	80.9%	

Source: APRA. For this purpose, banking assets are based on the measure of total exposures used in the leverage ratio, which includes both on- and off-balance sheet exposures.

## Annex 4: Areas for further guidance from the Basel Committee

The Assessment Team would like to point out a practical issue in the large exposures standards, which may benefit from some further analysis by the Basel Secretariat or the Large Exposures Group.

### Assets underlying structured vehicles with different levels of seniority

The issue relates to exposures to assets underlying structured vehicles with different levels of seniority, where APRA has added a cap to the Basel formula. The paragraphs containing the rule in question are paragraph 79 in the BCBS standards and paragraph 26 of Attachment A in APS 221. APRA has added a cap at the nominal value of the underlying asset to address a case, where the exposure to an asset, according to the BCBS methodology, exceeds the maximum loss the ADI could incur when the asset defaults. In that case, the cap limits the total exposure to such an asset to the maximum amount the ADI could lose when the asset defaults.

The Assessment Team agrees that the cap added by APRA to the BCBS formula may be sensible. In spirit, it follows the intention of the large exposures framework, ie calculating a bank's exposure to an asset by analysing the maximum loss a bank could incur if the asset defaults. In analysing whether such a cap is necessary, it also remains to be assessed how frequent/realistic the situation addressed by the cap appears in reality.

### Settlement risk

Furthermore, the Assessment Team would like to point out an issue related to settlement risk. The BCBS large exposures standards seem silent about settlement risk, which for a non-delivery versus payment transaction receives a capital charge under the capital adequacy framework. Since generally including settlement risks under the large exposures framework may arguably have a big market impact, some jurisdictions, including Australia, explicitly exempt settlement risk from their large exposures frameworks. The Assessment Team would like to request the Basel Committee for further clarification on the treatment of exposures related to settlement risk under the BCBS large exposures framework.

## Annex 5: Areas where APRA's rules are stricter than the Basel standards

In some areas, APRA has adopted a stricter approach than the minimum standards prescribed by the Basel Committee. These are listed below for information. The stricter rules have not been taken into account as mitigants for the overall or component-level assessment of compliance.

- APRA applies its rules to all domestic ADIs in addition to the internationally active ADIs.
- APRA does not allow ADIs to exempt sovereign exposures unless the exposures are held as HQLA, arise from the decomposition of derivatives, are to the Australian Government or the Reserve Bank of Australia and are denominated in local currency.
- APRA introduced an additional limit (50% of Tier 1 Capital) for exposures to foreign government or central banks that receive 0% risk weight under capital standards.
- APRA has a stricter rule for exposure values of "traditional" off-balance sheet commitments and uses only a 100% credit conversion factor in order to convert off-balance sheet items into exposure values.
- APRA requires ADIs to use the full 100% exposure value for all covered bonds.
- APRA limits a D-SIB's exposures to another D-SIB to 15% of Tier 1 Capital.