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Dear Sir/Madam

Discussion paper: Revisions to Large Exposures

The Australian Bankers' Association (**ABA**) appreciates the opportunity to provide comments on APRA's Discussion Paper *Revisions to Large Exposures* (**discussion paper**), APRA's proposed revisions to Prudential Standard APS 221 Large Exposures (**APS 221**) as well as the associated reporting standards, reporting forms and reporting form instructions

With the active participation of its members, the ABA provides analysis, advice and advocacy for the banking industry and contributes to the development of public policy on banking and other financial services. The ABA works with government, regulators and other stakeholders to improve public awareness and understanding of the industry's contribution to the economy and to ensure Australia's banking customers continue to benefit from a stable, competitive and accessible banking industry.

The ABA understands and accepts that APRA is seeking to adopt revisions to the large exposures framework that have been published by the Basel Committee on Banking Supervision (**BCBS**) and further calibrate and refine them in an Australian context. The ABA recommends that where possible and practical in the Australian context, APRA should adopt policies that allow for comparability and consistency across jurisdictions, yet ensure that Australian ADIs are not at a commercial disadvantage internationally.

In general, the ABA considers that many of APRA's proposed revisions will add to and enhance the effectiveness of the current large exposures framework in Australia. For example, amendments to the current framework could be made to address the new limits and connection between counterparties. However, some proposals in draft APS 221 appear to extend the BCBS standard and the ABA is concerned that a number of these additional APRA requirements cannot be implemented without significant cost, which far outweighs the benefits.

Consequently, this submission is divided into four parts:

- **Key policy issues:** which should be borne in mind in deciding how to adapt the BCBS proposals in the Australian context and whether to extend them further.
- **Key technical issues:** which will impact the ability to implement and comply with draft APS 221 going forward.
- **Implementation and timing**.
- **Appendix**: Technical issues which require additional clarification.

The ABA considers that the draft APS 221 should be implemented in line with the BCBS standard. If some of the additions suggested by APRA were removed it would still remain a highly effective and balanced policy framework in constraining counterparty risk in Australia.

The BCBS proposed a 1 January 2019 implementation date for the new large exposures framework based on the finalisation of the BCBS standard in 2014. However, with the delay in finalisation of the new APS 221 and the need for further consultation highlighted in this submission, the ABA recommends that the 'best endeavours' implementation date be set at least two years from the publication of the finalised Prudential Standard as well as the associated practice guides, reporting standards, reporting forms and reporting form instructions.

Key policy issues

The ABA believes that two key policy issues need to be borne in mind in deciding how to adapt the BCBS standard in the Australian context to potentially avoid unintended consequences.

Firstly, the BCBS standard has the positive effect of significantly reducing exposure limits and, in this way, it already goes a long way towards reducing potential counterparty risk. The standard establishes prudential limits for large exposures that are set relative to an Authorised Deposit-taking Institution's (**ADI's**) Tier 1 Capital. This is a narrowing of the capital base compared to the current APRA standard which refers to an ADI's Regulatory Capital, i.e. Total Capital.

This impact is exacerbated by a significant reduction in the limits, such that the exposure limit on a dollar basis is dramatically reduced or limits are introduced where under the current APRA standard there were none.

For example, domestic systemically important banks (**D-SIBs**) limits to other D-SIBs will be reduced by 75 per cent in dollar terms as per the calculations in the table below:

	Capital Measure		Capital Base Reduction	ADI exposure limit (50% of Regulatory Capital	Est. D-SIB exposure limit (15% of Tier 1 Capital)	D-SIB exposure reduction
ADI	**Regulatory ($m)**	**Tier 1 ($m)**	**%**	**Current APS 221[1]**	**Draft APS 221[2]**	**%**
ANZ	57,739	48,091	17%	28,870	7,214	75%
CBA	59,591	50,218	16%	29,796	7,533	75%
NAB	55,072	46,842	15%	27,536	7,026	75%
Westpac	56,609	47,245	17%	28,305	7,087	75%

Source: ANZ, NAB & WBC Pillar 3 Reports March 2017 (CBA December 2016)

[1] 50% of Regulatory Capital;
[2] 15% of Tier 1 Capital

The ABA wants to highlight that the 15 per cent limit for D-SIBs to other D-SIBs has been determined by APRA and was not prescribed by the BCBS. The 15 per cent limit has significant implications for liquidity management going forward, as well as potential implications for the functioning of the Australian short-term debt market and for daily cash settlement with the Reserve Bank of Australia (**RBA**). This submission will recommend a carve-out of Liquidity Coverage Ratio (**LCR**) eligible securities should APRA pursue this strict 15 per cent limit between D-SIBs.

Secondly, the ABA believes that the current APS 221 and APRA's supervisory model have worked extremely well to date in relation to large exposures. This is borne by the lack of examples where Australian ADIs have faced significant losses due to a sudden counterparty failure, so the ABA would query the benefit of APRA going beyond the BCBS standard. Consequently, the draft standard in its current form is potentially too far reaching, particularly the concepts of connected exposures and look-through exposure requirements.

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As APRA is aware, there are many examples globally where counterparty credit failures did take place, and this is what the BCBS has been prompted to address via the BCBS standard. The ABA believes that the current APS 221 works well from an operational and compliance perspective, is easily supervised by APRA, and facilitates consistency in application across ADIs. This existing comparability and consistency is not replicated in the draft standard.

Consequently, in deciding how to adapt the BCBS standard in the Australian context and potentially extend it further, APRA should consider the practice developed in relation to the current APS 221 and leverage current industry practices as much as possible. To the extent that the industry seeks further time to implement the revised APS 221, APRA should draw comfort from the effectiveness of the current standard and that both they and the industry can allow adequate time to implement and test the new framework.

Key technical issues

There are a number of technical issues which make some of the proposals in draft APS 221 unduly complex, onerous and difficult to comply with from a practical perspective. The major issues are discussed below. Those issues requiring clarification are included in a separate Appendix.

The ABA strongly recommends there be minimal variation from the BCBS standard with APRA only applying its discretion to clarify certain areas and appropriately modify those areas to work in Australia based on the existing APS 221 standard.

A number of the proposals in the draft APS 221 as it stands will have a significant impact on ABA members. The ABA and members would welcome further discussions with APRA to refine the proposed standard and its application.

Comments on the key technical issues come under the main headings of:

1) Divergence between the BCBS standard and draft APS 221
2) Clarification of Government-Related Entities, including government owned global systemically important bank (G-SIBs) exposures
3) Measuring exposures for the purposes of draft APS 221

Divergence between the BCBS standard and draft APS 221

There are some key differences between the BCBS standard and draft APS 221, many of which have been highlighted in the discussion paper. As a general principle, the ABA seeks harmonisation with BCBS standards to ensure cross jurisdiction consistency and comparability. The ABA considers a number of the proposed extensions in draft APS 221 may restrict the activities of Australian ADIs relative to international competitors.

15 per cent limit for an ADI’s exposure to a G-SIB

The BCBS guidance encourages jurisdictions to consider applying stricter limits (more than the base case 25 per cent counterparty limit) for exposures of smaller banks to global systemically important banks (**G-SIBs**), but does not specify a numerical limit. The BCBS has applied a limit of 15 per cent for exposures between G-SIBs and draft APS 221 has adopted this limit for all ADIs’ exposures to G-SIBs. The ABA believes this setting is too restrictive for Australia as:

- G-SIBs are typically major correspondent banking providers and trading counterparties, therefore, limiting G-SIB exposures could adversely impact ADIs.
- By imposing stricter limits on G-SIBs as compared to other banks, APRA assumes that an ADI always has an alternative to dealing with a particular G-SIB. This might not be possible due to scale, range of services in certain jurisdictions or credit risk appetite.

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- In general, Australian ADIs have established long standing relationships with some of these G-SIBs as hedging and correspondent banking counterparties given their strong credit profile. It would be an undesirable and costly outcome to force Australian ADIs to potentially deal with less desirable counterparties with weaker credit profiles.
- G-SIBs could be viewed as more resilient to losses than other ADIs, therefore, there should be no difference in limits for an ADI's exposure to G-SIBs or any other bank. G-SIBs are already subject to more intense supervision and extra prudential requirements when compared to non-G-SIBS. Further, ADIs that are G-SIBs may already be subject to a 15 per cent limit to other G-SIBs in their home jurisdiction.

Recommendation

The ABA recommends that APRA apply a 25 per cent exposure limit on G-SIBs which is consistent with the proposed limit to other banks in the draft standard as well as the minimum requirement of large exposure limits in the BCBS standard. If APRA considers there is a need to apply a stricter limit, the industry would argue that it should not be as strict as the 15 per cent limit the BCBS applies between G-SIBs.

15 per cent limit for exposures between D-SIBs

APRA proposes a limit of 15 per cent of Tier 1 Capital for all exposures between ADIs designated by APRA as D-SIBs. The ABA understands that this has been APRA's approach given the BCBS encourages jurisdictions to consider applying stricter limits for exposures between D-SIBs.

This lower limit has broader implications for the Australian financial market and there are several unintended consequences of this more onerous limit between D-SIBs that will be discussed in further detail below.

Recommendation

As detailed further below, the ABA recommends that exposures between D-SIBs exclude exposures in securities held for Liquidity Coverage Ratio (**LCR**) purposes and also interbank lending that facilitates cash settlement in the domestic market. Alternatively, though less preferably, APRA could lift the limit to be in line with the proposed limit to other banks and the broad counterparty limit of 25 per cent in the draft standard.

50 per cent limit on exposures to foreign governments or central banks with a zero per cent risk-weight

The BCBS standards do not include any limit on government or central bank exposures. APRA has proposed a 50 per cent limit for exposures to governments or central banks which receive a zero per cent risk-weight under APS 112[3] with the exception of exposures that are held for LCR purposes. This limit does not apply to a government-related entity (or the group of connected counterparties to which it belongs), where a 25 per cent limit will apply.

The ABA believes governments or central banks which receive a zero per cent risk-weight will be of a similar credit quality to the Australian Government and the RBA. It is not clear from a prudential risk perspective why APRA would exclude all exposures to the Australian Government or Australian dollar exposures to the RBA, but in the case of these zero per cent risk-weight government or central bank counterparties, only exposures held *specifically* for LCR purposes are excluded from being classified as a large exposure.

[3] APS 112: Capital Adequacy: Standardised Approach to Credit Risk, Attachment A: Risk-weights for on-balance sheet assets.

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With the new margining requirements for non-centrally cleared derivatives, i.e. OTC derivatives, there will be a bigger push to post government and central bank securities as collateral for market related contracts. When the exposure value to a counterparty is reduced due to an eligible credit risk mitigation (**CRM**) technique i.e. posting of collateral, an ADI must also recognise an exposure to the CRM provider equal to the amount that the original counterparty was reduced. ADIs will potentially replace an exposure on a market related contract counterparty with an exposure on the eligible government security collateral. The ABA would encourage APRA to avoid creating possible disincentives for posting or receiving high quality government securities as collateral.

Recommendation

The ABA recommends that APS 221 should be harmonised with the BCBS standard for foreign government and central bank exposures, i.e. there should be no limit on government or central bank exposures. This would also be consistent with APRA's existing APS 221 requirements for foreign government and central bank exposures.

Difference in exposure value for banking book traditional off-balance sheet commitments

The BCBS standard allows for off-balance sheet commitments to be measured by applying conversion factors used for the standardised approach to credit risk (with a floor of 10 per cent).

APRA has proposed that off-balance sheet commitments be converted by applying a flat 100 per cent conversion factor. This simple measure does not appropriately calibrate the credit conversion factors (**CCFs**) for the vastly different types of off-balance sheet commitments that exist.

Further, a 100 per cent CCF treatment itself is inconsistent with the existing leverage ratio calculation, the calculation of credit risk-weights in APS 112 Attachment B: *Credit equivalent amounts for off-balance sheet exposures*, and other off balance sheet exposures reported under ARF118.1.

It is unclear why APRA would deviate from the BCBS treatment for CCFs and this approach will result in an overstatement of exposures and a considerable variation of practice in Australia compared to global bank peers.

Recommendation

To ensure consistency and comparability of BCBS standards globally, the ABA recommends that APRA allow Australian ADIs to apply CCFs, as per the current APS 112: *Standardised Approach to Credit Risk* and any subsequent changes as a result of the finalisation of the Basel III reform proposals.

If a 100 per cent CCF treatment prevails, this will make ADIs less competitive compared to foreign banks for impacted products, such as certain trade products, due to pricing differentials and or limit constraints.

Difference in exposure value for covered bonds

The BCBS standard applies a concessionary treatment for covered bonds satisfying certain high quality criteria such that a covered bond may be assigned an exposure value of 20 per cent or more of the nominal value of the bank's covered bond holding.

APRA has not proposed to adopt the concessionary recognition of covered bond exposure values. In draft APS 221, ADIs will be required to recognise the full 100 per cent nominal value of covered bond holdings as the exposure value, allocating this to the issuer of the covered bonds.

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It is unclear why APRA would deviate from the BCBS treatment for covered bonds. Like the BCBS rationale, the ABA is of the view that covered bonds held by ADIs warrant a preferential treatment based on their legal design, bankruptcy remoteness and repo-eligibility under the Committed Liquidity Facility (**CLF**). Further, under APRA's proposed treatment, the exposure on the issuer of a covered bond will be treated the same as an unsecured exposure on the same issuer despite the dual recourse nature of these instruments. The ABA does not believe this is an accurate assessment of the risk.

Recommendation

APRA's approach to covered bonds will result in a considerable variation of practice in Australia compared to global bank peers. The ABA does not consider there to be any material difference in the risk profile of Australian covered bonds to that in other jurisdictions that would justify APRA adopting a more conservative approach for Australian ADIs.

Clarification of government-related entities, including government owned Global Systemically Important Bank (G-SIBs) Exposures

The proposed changes to APS 221 introduces a new concept – government related entities (**GREs**) – which will include state owned enterprises (**SOEs**). In certain countries, SOEs dominate the local economies, and from an Australian ADI perspective, SOEs in such countries will typically be relatively attractive counterparties. In addition, some of these SOEs may include G-SIBs, which will carry an individual 15 per cent limit. For example, in the case of China, the Chinese Government controls four G-SIBs.

The BCBS standard specifically states that these entities do not need to be aggregated if they are only connected due to common control of government or central bank. The ABA agrees with this approach and would also recommend that APRA broaden the test of common control to include sovereign wealth funds (**SWFs**). Including SWFs for this purpose facilitates consistent assessment of GREs across jurisdictions regardless of whether these entities are legally owned or controlled by a government, central bank or SWF. Furthermore, SWFs are highly important to sovereigns and as such their risk profile is closely aligned with the sovereign reflecting that:

- SWFs by their nature are a store of financial reserves to provide for the future obligations of their respective sovereign.
- In some jurisdictions the activities of central banks and SWFs are indistinguishable.
- There are often constitutional protections over the reserves SWFs manage.
- Their role is often mandated under legislation (e.g. Australia's Future Fund).
- The Boards of SWFs tend to comprise government officials.

The above is a significant point of differentiation under draft APS 221 whereby a single group based on government control is to be aggregated, i.e. satisfies definition of 'connected', and would potentially lead to a very large group. This is exacerbated when the group includes government controlled G-SIBs.

More than just a point of differentiation from the BCBS, the ABA believes that APRA should not require ADIs to aggregate SOEs together based purely on control.

Separately, the definition of GREs in paragraph 8 of APS 221 states that they are controlled by "any level of government (including central, state or regional governments)". Should APRA not adopt the BCBS proposal, the ABA believes they should clarify that exposures be aggregated by individual government and not nationally, i.e. national and state governments should not be combined.

Recommendation

To address these issues, the ABA recommends that APRA:

- adopts the BCBS proposal to not aggregate government controlled entities who are otherwise unconnected except for the fact they are controlled by the same government or central bank;
- for completeness, consistency of policy and intent, extend this test of control to SWFs; and
- clarify that government related exposures be only aggregated by individual government and not nationally.

Measuring exposures for the purposes of draft APS 221

The draft APS 221 is more prescriptive compared to the existing APS 221 and effectively results in the introduction of another measure of exposure that is different to the current reporting treatments under the relevant prudential reporting standards for the purposes of calculating risk-weighted assets, e.g. APSs 112, 113 and 116.

Thus, in the spirit of balancing risk sensitivity, simplicity and comparability, the ABA recommends that exposure at default post credit mitigation as calculated under the relevant prudential standards is the right measure of exposure in the context of APS 221. This will provide consistency and require less systems changes than needed under the proposed exposure measurement treatment.

For the significant cost and time to implement the proposed exposure definition there is no clear benefit in doing so versus the approach currently undertaken.

Structured vehicles

Any approach that requires an ADI to look-through exposures to the underlying assets of a structured vehicle will be very burdensome and will require significant investment in ADIs' systems, management and monitoring processes. The level of transparency and market reporting of such entities vary considerably and it is common for such entities to report limited information on an infrequent basis. Given the nature of some of these structured vehicles, the underlying assets can or will vary daily and it will be very difficult for an ADI to provide an accurate position of its exposure on a pro- rata basis.

The ABA supports the APRA position that such an investigation only applies once an underlying asset of the structured vehicle is greater than 0.25 per cent of an ADI's Tier 1 Capital base. However, in practice, identical structured vehicles would be treated differently across ADIs as the threshold test is based on an individual ADI's Tier 1 Capital base.

Recommendations

In responding to the discussion paper, the ABA needed to spend a significant amount of resources in interpreting the requirements of the draft APS 221, particularly in regards to APRA's requirements for structured vehicles. It would be a fair representation to say that there are numerous interpretations and a significant number of clarifications are being requested (see Appendix A). The ABA strongly recommends that APRA undertakes face-to-face engagement with industry prior to the finalisation of the standard and the ABA is happy to facilitate these workshops.

The current drafting poses a number of technical questions and the ABA requires further clarification on elements of application of the measurement of exposure for structured vehicles. A number of specific recommendations are included in the Appendix, however the ABA also has some broad recommendations:

- As a general proposition, exposures already assigned to a counterparty under another application of the standard should not be 'looked-through' and counted twice by reference to exposure values of underlying assets. It should be made very clear that the application of paragraphs 21-29 of Attachment A should be applied after any CRM and netting as per

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paragraphs 2 to 7 of Attachment A, i.e. the exposure in question is the exposure after CRM and netting has been applied.

- The APRA concept of 'investment in structured vehicles or vehicles which invests in other assets' is too broad and would benefit from further refinement. While examples provided in paragraph 21 of Attachment A of draft APS 221 are useful, there is considerable ambiguity on what is covered. ADIs had different opinions on the types of investments and exactly what entities or structures are actually covered by this proposal. A comprehensive list of these types of investments and structures is required to avoid implementation inconsistencies across ADIs. The ABA is happy to facilitate such discussions.
    - This clarification in particular is critical as it relates to the 'look-through' concept. The ABA recommends that APRA confirms that banking services and facilities provided to a structured vehicle, e.g. credit exposure/loan facilities and swaps, be treated as an exposure to the structured vehicle itself and that look-through would not be required. This is a sensible outcome as these relationships are very different to an ADI making an investment in a structured vehicle, in which case, the look-through approach to exposures could apply.
- The use of the term "assets" is too broad. It is conceivable that a structured vehicle may invest in an underlying asset which has no counterparty or credit obligations. The ABA recommends that the four specialised lending subclasses defined in paragraph 43 of APS 113 be carved out of the APS 221 definition of structured vehicle. References to index positions (paragraph 13 of Attachment A) create further ambiguity in the current draft standard.
- The ABA welcomes the exclusion for exposures to RBA repo-eligible residential mortgage-backed securities (**RMBS**) however, recommends this should be extended to include securities used as collateral to obtain funding via a repurchase agreement with a central bank (including the RBA) for similar reasons to the exclusion of repo-eligible RMBS.
- While the flowchart in the discussion paper is useful, hypothetical examples with dollar amounts would be very useful to ADIs to clearly understand what is required, especially given paragraphs 23 and 24 of Attachment A and requirements to pro rata exposures based on underlying assets. Currently paragraph 21 of Attachment A does not correctly reflect the flow chart or the BCBS large exposure framework nor allows for partial look-through. We recommend this be reflected correctly.
- Paragraph 21 section (b) (ii) that requires an ADI to aggregate "unknown" exposures of a structure to other such "unknown" exposures if they exceed the 0.25 per cent threshold of an ADI's Tier 1 Capital base. The ABA recommends that if this is required that an 'unknown' group be established for each special purpose vehicle (**SPV**) without the need to aggregate 'unknowns' of different SPVs.

Third parties and additional risk factors

- The last sentence on page 23 of the discussion paper suggests that "the exposure value to the liquidity provider is the sum of all the investments in structured vehicles with this liquidity provider". This could result in an exposure to the third party counterparty which is far in excess of its commitment to the structured vehicle and the exposure to the structured vehicle itself being counted several times. Consistent with the BCBS framework, APRA should clarify that it is only investments in the structured vehicle that are being considered, not other types of exposures.

- There is some uncertainty as to whether or not the existence of common third party service providers with non-financial service obligations would necessitate aggregation of exposures in structured vehicles. In these circumstances APRA should clarify that where such service providers, including originators, may legally be replaced. No aggregation of structured vehicle investments will be necessitated by reason of commonality of service providers.
- Exposures arising to Lenders Mortgage Insurance (**LMI**) arising from insured mortgages are excluded under paragraph 18(g). APRA should clarify that this exclusion also applies to aggregating exposures in structured vehicles where LMI may be considered an additional risk factor.

Economic interdependence relationships

The ABA is concerned that APRA's proposed approach in measuring exposures on a basis of "economic interdependence criteria" for connected counterparties is not in line with current and established risk management practices. The requirements as per the draft APS 221 standard has the potential to be too far-reaching in the aggregation of exposures and it is not clear where the requirement to aggregate stops.

The cost of establishing the new databases and systems required to link that additional information with existing exposure systems will be very expensive and time intensive to implement. Equally, the ongoing management requirements will be very burdensome and might pose the additional risk of diverting key management attention and resources from more critical and useful aspects of risk monitoring and management.

The criteria outlined in paragraph 24 of draft APS 221 requires ADIs to apply qualitative judgments to determine economic interdependence. It expected that this will result in inconsistent implementation among the Australian banks and to that of global peers.

Economic interdependence relationships are extremely difficult to determine and apply as they imply connecting/aggregating a significant number of different types of relationships, e.g.

- Employee - employer
- Tenant - landlord
- Counterparties that have a common majority financier
- Third party supplier arrangements

While the 5 per cent of an ADI's Tier 1 capital will limit the number of cases to be reported, such a threshold will have limited benefit if an ADI has not progressively collected information on all potentially connected exposures prior to an exposure exceeding the proposed 5 per cent threshold. Further, in some cases, it may be impossible for the ADI to collect this information as it belongs to third parties where there is no direct relationship with the ADI or is commercially sensitive information that is not readily available.

While a given economic interdependence relationship exposure may not be relevant for aggregation at a certain point in time, in the future there may be a need to aggregate such an exposure. Being able to perform this assessment in the future means ADIs must implement the relevant system changes to capture and monitor economic interdependence relationships for every exposure on an ongoing basis. Hence, it is hard to see that a ADIs would be able to meet the 'economic interdependence criteria' on a retrospective basis.

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Recommendation

The ABA considers that the costs associated with assessing economic interdependence far outweigh the benefits. The cost of the processes and infrastructure required in each ADI to implement economic interdependence is significant (hence the ABA request for a two-year implementation timeframe). The costs to be borne far exceed any benefit to APRA's prudential objectives or systemic stability.

The ABA strongly recommends that such an approach not apply at all. However, if this requirement must apply, then the economic interdependence criteria should only apply to corporate exposures and connecting relationships, and ADIs should be able to apply judgment in determining whether or not the test is met. The ABA would recommended the following amendments:

- APRA should provide clear exclusions to the economic interdependence relationship requirements. The exclusions should include all retail managed exposures and the connections/relationships listed above. The exclusions should be complemented with an exposure threshold on the counterparties that may need to be linked by economic dependence.
- Paragraph 24(b) of the draft APS 221: if there is a partial guarantee; the amount connected to the guarantor should be limited to the amount of their guarantee.
- Paragraph 24(c) of the draft APS 221: clarification is sought as to the intent of this paragraph and why it is required in addition to paragraph 24 (a), however, if this paragraph is to remain, the term "significant part of a counterparty's business" needs to be defined in percentage terms.

The ABA wishes to emphasise again, that the cost and complexity to implement economic interdependence in Australia will be significant, and these costs far outweigh any benefit to APRA's prudential objectives or systemic stability. The technology build associated with the assessment of economic interdependence is one of the main drivers of the ABA's request for a two year implementation timeframe.

Unintended consequences for other prudential objectives

As part of the ABA's assessment of draft APS 221 in the Australian context, we have assessed the ability for ADIs to comply with the draft standard as proposed with consideration of other prudential objectives and impacts on Australian financial markets. Analysis has highlighted potential unintended consequences created through a 15 percent D-SIB limit on the LCR, setting of the Bank Bill Swap Rate (BBSW), and the operation of the real time gross settlement (**RTGS**) payments system.

Impact on the LCR framework

When the LCR was implemented in Australia, APRA prescribed that the only assets that qualify for high-quality liquid assets (**HQLA**) are notes and coin, balances held with the RBA, and Commonwealth Government Securities and Semi-Government Securities (**CGS and Semis**). There are no eligible Australian HQLA2 assets and APRA chose not to adopt HQLA2B.

Subsequently, APRA and the RBA announced that ADIs will be able to establish a CLF with the RBA. The need for such a facility arises due to the relatively short supply of Australian dollars HQLA[4], and the RBA's determination that banks (those subject to and not subject to the LCR) should hold no more than 30 per cent of the CGS and Semis on issue to avoid impairing the functioning of the Australian Federal and State Government bond markets[5].

4 APRA's open letter to ADIs 30 September 2016

5 Guy Debelle, speech entitled "Liquidity in Australian Fixed Income Markets", (21 June 2016)

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The CLF allows ADIs to repo certain assets with the RBA to recognise alternative liquid asset treatment for the LCR. These assets include repo-eligible senior debt, covered bonds and RMBS issued by ADIs, as well as internal RMBS. These securities must be highly liquid, generally highly rated and well diversified.[6] As a result, ADIs hold material amounts of securities issued by other ADIs for the purpose of qualifying for the CLF.

There is a risk that the proposed D-SIB limits are too low to enable ADIs to continue to hold the level of repo-eligible assets to satisfy the CLF and also support the buffers that the ADIs have recently been holding (approximately 5 per cent). Although the CLF allows ADIs to repo issuance by non-major banks, the availability of securities in highly-rated categories is limited and, further, is generally illiquid. Of all non-major bank vanilla repo-eligible securities available to purchase, 79 per cent have an outstanding value of less than AUD$1 billion, compared with only 50 per cent of major bank securities.[7] In a stressed market scenario where new issuance is constrained and additional liquidity buffers may be required, the need to utilise the CLF is likely to increase and the currently proposed D-SIB limits will not accommodate this.

A further consequential impact of the lower D-SIB limit is that the Australian D-SIBs will lose a significant investor base for their Australian issued debt securities, i.e. the other Australian D-SIBs. Given the smaller Australian investor base, the D-SIBs will have to increase their reliance on offshore wholesale funding to replace the funding that is currently raised in the domestic market. This is typically viewed to be a credit weakness by the rating agencies.

Recommendation

Given the importance placed on liquidity since the global financial crisis and the significant work put into implementing a strong but workable LCR framework in Australia, a limit of 15 per cent between D-SIBs would significantly undermine the LCR. For this reason, the ABA recommends a carve-out of securities held for LCR purposes to complement the implementation of the CLF in Australia. In the same way in which APRA exercised discretion in light of specific market conditions in Australia to introduce the CLF, it should exercise a discretion in relation to the D-SIB large exposure limits.

Alternatively, but a less optimal solution as there is still a risk of unintended consequences, the proposed D-SIB limit should be set at a higher level which clearly facilitates the CLF, including in a stressed market scenario.

Impact on the functioning of the ADI short-term debt market as a determinant of BBSW rate setting

A further yet separate point is the requirement that the short-term ADI-issued market specifically remains deep, liquid and active to assist with the BBSW rate set mechanism, which forms the basis of corporate customer product pricing in the Australian market. APRA highlighted this in January 2014 as one of its principles in assessing collateral mix in the LCR[8]. Restrictions relating to large exposure limits could prevent prime banks from posting tight bid offer spreads for short-term paper, which may inhibit participation from buy side investors in the new volume weighted average price BBSW methodology. The ABA sees this as a separate and distinct point to the requirement of ADIs to hold bank bills for the purposes of satisfying the CLF and warrants careful consideration in assessing the ability for D-SIBs in particular to comply with the draft APS 221.

[6] APS 210 Attachment A (December 2013) APRA response to submissions: Implementing Basel III liquidity reforms in Australia

[7] RBA Eligible Securities as at 6 June 2017 (Foreign and Supras; Australia government guaranteed securities; Other AAA rated securities; and ADI securities); Bloomberg

[8] APRA open letter to ADIs 30 January 2014

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Impact on cash settlement between ADIs to facilitate AUD settlement with the RBA

Part of an ADI's exposure to another ADI is comprised of overnight trades required to facilitate daily AUD settlement with the RBA. These values are included in the calculation of large exposures under the standard as it is a point-in-time assessment of compliance. These cash limits are essential for the cash market to settle at the end of the day in the RTGS payment system given long or short positions can be as high as AUD $2 billion.

In isolation, the 15 per cent D-SIB limit is unlikely to significantly impact the cash settlement system, however, when combined with D-SIB holdings in either or both of the above situations, an ADI's ability to meet the RBA expectation that market participants will lend to each other to facilitate cash market settlement is likely to be impacted. Further, the volatility in the volumes and timing of payments across a 24-hour window adds complexity to be able to manage daily exposures from the outset with any great certainty.

The ABA acknowledges that there may be some remedy for this unintended consequence through repo trading instead of unsecured cash. However, this will need the market to adapt and smaller ADIs to restructure their balance sheets. This warrants a separate more detailed analysis and consultation with the RBA and industry.

Implementation and timing

Timing of the submission of ARF 221.0 Large Exposures report

The ABA requests APRA considers and prioritises the large volume of concurrent regulatory reforms impacting the sector when considering their final policy response to submissions on this consultation. We also urge APRA to ensure consistency in definitions between ARF 221.0 and the economic and financial statistics (**EFS**) program.

In regards to ARF 221.0 the ABA highlights the following:

- Separately, existing internal processes designed to meet the ARF 110 Capital Adequacy Return on business day 30 may mean that a draft Tier 1 Capital number may not be available until business day 20 on average, which is on or after the proposed calendar day submission requirement for ARF 221. This will not leave enough time to calculate large exposures based on the new Tier 1 Capital base.
- Generally a calendar day timetable will mean that each quarter reporting timelines will decrease by approximately 1 to 2 days and that the initial four proposed submission dates all fall on 'non-business' days, i.e. Sundays or the Australia Day public holiday in January 2019.
- It is standard practice to operate on a business day timetable and producing returns on a calendar day basis would require changes to ADI's systems, with people and processes to be flexible in managing this ad-hoc timetable.

Recommendation

The ABA understands calendar day reporting across the industry is becoming more common place.

We recommend APRA retains the current reporting period for the ARF 221.0 return being 30 business days following the end of the quarter, at least on a transitional basis. This would facilitate a smooth transition in a time of immense regulatory change for the industry.

Timing of implementation

The proposed BCBS implementation date for the new large exposures framework of 1 January 2019 was reasonable based on the finalisation of the BCBS standard in April 2014.

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However, as highlighted in this submission, with the delay in finalisation of the new APS 221 and the need for further consultation, the ABA recommends that the implementation date be set to be at least two years from the publication of the finalised Prudential Standard as well as the associated reporting standards, reporting forms and reporting form instructions.

Conclusion

The ABA believes that the current APS 221 and APRA's supervisory regime have worked extremely well to date in relation to large exposures. We do have a number of significant concerns with the proposed new standard, therefore the ABA and its members would welcome the opportunity to conduct workshops with APRA to refine and clarify the requirements of the new APS 221 prior to its finalisation and release. The ABA would suggest and facilitate technical workshops on structured vehicles, additional risk factors, economic interdependence and D-SIB limits.

Yours faithfully

Signed by

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Appendix: ABA comments on draft standards - Large Exposures

Paragraph	Section	ABA comments
	Definitions	
8	Definition of a government-related entity.	The ABA would welcome confirmation that in the definition of a government-related entity, which states: “any level of government” also includes local government. The ABA would also welcome a definition for “public sector entity”. We recommend that a public sector entity that is treated as a sovereign according to risk based capital requirements is also treated as a sovereign for the purposes of large exposures. For example, are all public sector entities that are aggregated assumed to be government related? The ABA would hold that ADIs are not expecting to have to classify state governments of Australia as ‘public sector entities’. If they were classified as such, then all state governments would be aggregated as Group of Counterparty names (connected) as Commonwealth Government related entities.
	Identifying large exposures	
18	**Unintended consequences impacting on the LCR and other prudential requirements** The inclusion of securities that are held for other prudential reasons in the exposure calculation creates challenges for ADIs to meet their prudential obligations, for example, the LCR.	The ABA recommends that exclusions from the large exposure definition should be expanded to also include: • RBA repo eligible securitisations. • Exposures to other ADI’s held for LCR purposes (including RMBS). • Exposures of wealth management entities in the Level-2 group that are held to meet their prudential capital requirements.

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Paragraph	Section	ABA comments
		• Overnight exposures to other ADIs created through lending between market participants in order to enable the cash market to settle at the end of each day. • Short-term ADI issued securities to assist with the BBSW rate setting mechanism. • Exposures to the New Zealand Government or any New Zealand dollar exposure to the Reserve Bank of New Zealand.
18		The current APRA standard refers to a number of exclusions. The ABA would welcome confirmation that these exclusions will continue to apply in the new APS 221. For example: • Exposures to the extent that they are secured by cash deposits • Exposures arising in the course of settlement of the market – related contracts • Exposures to an ADI as part of an industry support contract relating to liquidity certified by APRA under s.11CB of the Banking Act. • Settlement risk (para 16 of current standard) - The ABA notes that settlement risk can fluctuate materially which will make management within limits difficult for ADIs.
18(b)	Paragraph 18(b) states "exposures to the extent that they have been written off;"	The ABA would welcome a clarification of how the exclusion of write-offs from large exposures should be interpreted, i.e. should ADIs record exposure at default (EaD) post write-off of specific provisions?
18(d)	Does the exclusion for exposures to governments or central banks for LCR purposes apply to the LCR at both a country and group level?	The ABA would recommend that the requirement apply at the group level.
18(e)	Exclusion of intra-day interbank exposures.	As no reference is specifically made to exclusion of intra-day non-bank exposures, the ABA would welcome clarification whether intra-day non-bank exposures are to be included in the large exposure calculation for non-banks. Also if settlement exposures

Paragraph	Section	ABA comments
		are not a general exclusion can they be excluded as intra-day exposures?
19	The paragraph states: "Where an exposure that has been excluded is hedged by a credit derivative, an ADI must recognise an exposure to the counterparty providing the credit protection in line with paragraph 5 of Attachment A."	The ABA notes that this may not be possible from a trading book perspective as ADIs don't match hedges, - rather this is all done at portfolio level.
20	**Connected counterparties** Paragraph 20 refers to the "**default** of one individual counterparty is **likely** to cause other counterparties to default."	The ABA seeks confirmation that both phrases are to be defined as per the examples provided in paras 21 – 28. We would also welcome further guidance on the following questions. 1. How is 'default' to be defined? 2. Does 'default' mean only monetary event of default or the definition of default as derived from paragraphs 24 to 26 of APS 220? 3. How is 'likelihood' to be assessed? Paragraph 24 refers to the financial soundness of one counterparty affecting the financial soundness of another counter party rather than 'default'. The ABA would welcome clarification as to reasons for differing terminology between paragraphs 20 and 24. Are ADIs to consider 'default' as the correct or an acceptable proxy for financial soundness? As per the main section of this submission, the ABA recommends an APRA/ADI workshop on connected counterparties prior to the finalisation of the prudential standard.
21		If multi dependencies are identified for different entities, ADIs are likely to include the same counterparty (and/or exposure) multiple times in the different connections. Is this APRA's intention, or should ADIs include the same counterparty (and/or exposure) only once? Connecting a counterparty or exposure multiple times creates significant complexity for customer management, data management and reporting. The ABA recommends that the same

Paragraph	Section	ABA comments
		counterparty (and/or exposure) be included only once, and would welcome APRA's clarification.
21(a)(iii)	The paragraph states, "other connections or relationships which, according to an ADI's assessment, identifies the counterparties as constituting a single risk".	The ABA would welcome additional APRA guidance as to what constitutes a 'single' risk.
22(b)	Significant influence over appointment of administrative functions, management, board committees or Board, could extend a control relationship to a fund or asset manager, notwithstanding the fact that these arrangements could be overturned or terminated.	The ABA would welcome clarification on the intention and application of paragraph 22(b).
22(c)	The identification of control relationships via senior management involvement is very difficult to identify and monitor.	The ABA proposes that paragraph 22(c) should be removed. In the alternative the ABA requests APRA provide worked examples in the final APS 221 standard that will ensure ADIs can apply and meet this obligation consistently and efficiently.
24	Paragraph 24 contains a requirement to identify all counterparties linked by an economic interdependence relationship where exposure to a counterparty exceeds 5 per cent of Tier 1 Capital. As discussed in the main section of the submission, the changes required for ADIs to meet their obligations in paragraph 24 would be significant. **Economic interdependence relationships are extremely difficult to apply as they imply connecting/aggregating any number of potential relationships** Capturing indirect client relationships is quite subjective and very dependent on a strong understanding of the clients' business and business relationships. It is very difficult to make prescriptive rules that would adequately capture these relationships. For example, looking at the implications for supplier relationships could be very industry specific and in some instances are dynamic in nature. In addition, trying to capture 'connected' entities is a highly manual, imperfect exercise. **The application of the 5 per cent threshold provides limited assistance** Banks would be forced to monitor the exposures of a wider population of counterparties, even those below the 5 per cent threshold, to make sure that a counterparty is reported once it reaches the threshold. Being able to perform this	The ABA would welcome an APRA definition of 'economic interdependence relationships', together with examples and guidance as to how far it extends, for example: • What are APRA's expectations of when an ADI should commence tracking of a counterparty where an economic interdependence relationship exists, but which currently sits below the 5 per cent limit? • Does the connected entity concept now mean that there is in effect a two-tier aggregation policy? • As a general principle, when an economic interdependence relationship exists, but the impact of a counterparty failure can be mitigated by replacement with another counterparty, can that be excluded from aggregation? It may be difficult to access certain information critical to assessing economic interdependency. For example, there are instances where information will be proprietary in nature and hence unavailable to the ADI. In other instances the connected

Paragraph	Section	ABA comments
	assessment in the future means banks must implement the relevant system changes to capture and monitor economic dependence for every exposure on an ongoing basis. **The application of economic interdependency does not appear … to differentiate between the credit quality of the differing underlying exposures. For example:** In a distressed scenario, a major retailer could be sold as a going concern, and behave quite differently to a discretionary retailer. Should distinguishing around the nature of the exposure/likely substitution figure into the concept of contagion? Similarly, a strong market leading brand with a material portion of its sales through a distribution vehicle would likely find an alternate distribution vehicle.	relationship will be dynamic or periodic, and therefore challenging (if not impossible) for an ADI to monitor and maintain. ADI's need to be able to make an assessment based on historical information and expert judgement. The ABA recommends that passing the threshold should not make connecting binary if, for example, the customer or supplier were replaceable with only minor disruption to financial performance expected. The ABA would welcome confirmation whether there is an intention for the draft standard to require a secondary leg to the connected counterparty concept? Is it the intention to require aggregation of a third entity that would default if, for example, the landlord defaulted due to the tenant not paying the rent, i.e.: • A large retailers (entity A) rent makes up > 50 per cent of entity B's gross revenue. • Entity C is the provider of a very specialised consultancy service to entity B and the default of entity B would likely lead to entity C's default. • Is the intention to require all three entities to be considered connected counterparties? • If the intention is 'yes' to the above points, would this be the same if there was an entity D that was reliant on entity C etc.? If this scenario is one whereby all counterparties are to be connected, it is very easy to conclude that most counterparties will need to be connected. The ABA requests clarification of this point.
24(b)	An economic interdependence relationship exists if; one counterparty has fully or partly guaranteed the exposure of the other counterparty, or is liable by other means, and the exposure is significant, such that the guarantor is likely to default if a claim occurs.	The ABA seeks confirmation that if a guaranteed exposure is not significant (to either party) and/or no default on the part of the guarantor is likely, then economic interdependence does not exist.

Paragraph	Section	ABA comments
24(d)	An economic interdependence relationship exists if the expected source of funds to repay the loans of both counterparties is the same, and neither counterparty has another independent source of income from which the loans may be fully repaid.	The ABA would welcome clarification whether counterparties connected with each other or with the source of funding? Also, if another independent source of funding is readily available, although may not currently be in place, can it be assumed that economic interdependence does not exist?
24(e)	An economic interdependence relationship exists if; it is likely that the financial difficulties of a counterparty would cause difficulties for the other counterparty in terms of full and timely repayment of liabilities.	The ABA would welcome guidance on the application of paragraph 24(e). For example, in the case where individual suppliers may be dependent on a single customer, but that single customer is not dependent on the financial health of individual suppliers. Such that the relationship is one-way only.
24(g)	An economic interdependence relationship exists if; two or more counterparties rely on the same source for the majority of their funding and, in the event of the common funds provider's default, it is expected that an alternative funds provider cannot be found.	The ABA would welcome clarification as to the reasons why 24(d) and 24 (g) differ. In this instance are counterparties connected with each other or with the source of funding?
25	Connected Counterparties.	Should individuals that come from a family unit that has only one wage from one employer, have their debts aggregated with that employer as their financial soundness is arguably inter connected? Family members are excluded from being connected where they have independent retail relationships, but this is not extended to employees. Are employees required to be aggregated? If the exposures to the individuals are less than 5 per cent of Tier 1 Capital, the ABA would recommend that ADI's not be required to connect the individuals with the employer even if exposures to the employer exceed 5 per cent of Tier 1 Capital.
26	Despite being excluded as a large exposure, QCCP exposures are required to be reported.	ABA recommends that QCCP exposures should be reported on a post credit mitigation basis only.

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Paragraph	Section	ABA comments
27	The ABA would welcome confirmation that government related entities (**GREs**) must not be treated as connected to governments and central banks. where: 1. a control relationship exists between the government and the GRE (as set out in paragraph 22) 2. economic interdependence exists between the government and the GRE (and any entity) (as set out in paragraph 24). The ABA would also welcome clarity on the question whether GREs (where 'related' to the same government) are to be: 1. treated as a group of connected counterparties and as if the group is a single counterparty; or 2. treated as if each GRE is a single counterparty until the 5 per cent trigger is actioned and then aggregated with all other government entities to form a group of connected counterparties?	The ABA requests that APRA provide a definition of GREs for ADIs to appropriately assess whether certain entities such as sovereign wealth funds, are to be considered as government or GREs. At the GREs level, the ABA view is that these GREs should not be aggregated purely because they have a common parent, common counterparty that has significant influence or common senior manager. Nor should common economic interdependence require connecting GREs, with the exception of the application of paragraph 24(b). A GRE would be connected with its subsidiaries by applying the thresholds in paragraph 22. APRA has identified that the risks associated with these entities are different from the government itself, and the ABA believes that it then follows that these risks are different and distinct for each GRE.
27	Does paragraph 27 apply to all layers of government and GREs?	The ABA would welcome further APRA guidance and worked examples where appropriate in the final APS 221 standard that will ensure all ADIs can apply and meet this obligation consistently and efficiently.
27	Paragraph 27 and footnote 6 imply that multiple limits will be required to be monitored for government groups and their related entities. Does this mean ADIs will be required to set up two separate government groups for large exposure limit purposes, i.e. • 25 per cent of an ADI's Tier 1 Capital for exposures to governments or central banks that does not qualify to receive zero risk-weight under APS 112; and • 25 per cent of an ADI's Tier 1 Capital for all other sovereign exposures, (this is state - owned banks, SOE and G-SIBs that are state owned (and the 15 per cent cap for G-SIBs) will need to fall within the 25 per cent of the government group large exposure limits). • Could there be multiple GREs and other connected counterparty groups?	The ABA would welcome further APRA guidance and/or worked examples in the final APS 221 standard that will ensure all ADIs can apply and meet this obligation consistently and efficiently.

Paragraph	Section	ABA comments
28	The ABA's view is that economic dependence involves judgement which should be left to an ADI's discretion rather than be subject to APRA approval. Therefore the ABA recommends APRA replaces paragraph 28 in the draft standard with paragraph 27 from the BCBS standard. **BCBS's paragraph 27**: "There may, however, be circumstances where some of these criteria do not automatically imply an economic dependence that results in two or more counterparties being connected. Provided that the bank can demonstrate to its supervisor that a counterparty which is economically closely related to another counterparty may overcome financial difficulties, or even the second counterparty's default, by finding alternative business partners or funding sources within an appropriate time period, the bank does not need to combine these counterparties to form a group of connected counterparties".	The ABA recommends that the requirement for APRA approval for exemptions should be limited to control relationships only. The ABA is of the view that paragraph 27 of the BCBS framework provides the appropriate level of discretion for ADIs to best manage large exposure concentration risk and operational realities, whereas paragraph 28 as currently drafted is more onerous on ADIs, and places an excessive dependency to seek APRA approval. In regards to BCBS paragraph 27, the ABA would also recommend that the interpretation of the words "bank can demonstrate", would involve an ADI documenting the decision and retaining appropriate detail should APRA seek this information. The ABA would not recommend the information be provided to APRA as a matter of course, due to the cost and resourcing impost it would place on both ADIs and APRA...
	Large exposure limits	
29(a)	This 50 per cent limit also includes previously excluded exposures to the extent that they have been guaranteed by or secured against securities issued by governments or central banks which receive a zero per cent risk risk-weight in accordance with APS 112 Attachment A as long as guarantees / securities used for CRM are allowed in APS112. The ABA would welcome clarification that this 50 per cent limit does not apply to the GRE or to the group of connected counterparties to which it belongs, such that APRA guidance confirms that the 25 per cent limit applies to single GREs only and not to a group of GREs. Currently, there is no overall limit on exposure to a group of related GREs. The ABA would welcome clarification as to what does this 25 per cent limit mean for an ADI, especially in situations of state ownership?	The ABA would welcome further APRA guidance and/or worked examples in the final APS 221 standard that will ensure all ADIs can apply and meet this obligation consistently and efficiently.

Paragraph	Section	ABA comments
29(a)	For sovereign exposures that qualify for zero risk-weight, (in the event these are downgraded below AA-) these exposures will no longer qualify for the 50 per cent limit, but rather the 25 per cent limit. The ABA would welcome clarification whether at the point of downgrade these exposures will be viewed by APRA as a passive breach of large exposure limits in the event of the exposure being >25 per cent. The ABA would welcome guidance on what transition period APRA will allow an ADI to report and manage down to < 25 per cent or grant an exemption.	The ABA would welcome further APRA guidance and/or worked examples in the final APS 221 standard that will ensure all ADIs can apply and meet this obligation consistently and efficiently.
29(b)		The ABA would welcome further guidance on whether paragraph 29 (b) applies to exposures to the G-SIBs only or does it also include exposures to deposit taking subsidiaries and exposures to non-deposit taking subsidiaries.
29(c)	As per 29(b) above, would paragraph 29 (c) apply to exposures to the D-SIB only or does it also include exposures to deposit taking subsidiaries and exposures to non-deposit taking subsidiaries.	The ABA would welcome further APRA guidance and/or worked examples in the final APS 221 standard that will ensure all ADIs can apply and meet this obligation consistently and efficiently.
29(b)(c)	With the reduction in D-SIBs and G-SIBs large exposure limits, there may be instances where existing aggregated groups will exceed the proposed limits.	The ABA would welcome further APRA guidance on what would be the consequence of an excess beyond the proposed limits.
	Prior consultation requirements	
34	The prior notification threshold of 10 per cent applies to all types of counterparties.	The ABA recommends that a threshold for prior notification should not apply to counterparties subject to the 50 per cent limit, or a higher threshold than 10 per cent should apply.
	Significant risk concentrations	
39		In regards to this paragraph, the ABA would welcome clarification as to what factors are taken into account when determining a “significant level of risk concentration”.

<table>
<tr><th>Paragraph</th><th>Section</th><th>ABA comments</th></tr>
<tr><th>Attachment A</th><th>Measuring large exposure values</th><th></th></tr>
<tr><td>1(a)</td><td>Banking book on-balance sheet assets: measured as accounting value net of specific provisions and value adjustments.</td><td>The ABA would welcome APRA’s guidance on the definition of “accounting value net of specific provisions and value adjustments”, as currently the risk systems of ADIs reflects balance outstanding at face value.

Additionally, does “net of specific provisions” require an ADI to deduct individual provisions? Does it mean net of individually assessed provisions (IAPs) and collectively assessed provisions (CAPs) as per APS 220 Credit Quality?

Guidance would also be welcome on what other “value adjustments” are envisaged by APRA.

Guidance would also be welcome on whether the new definition requires the reporting balances as balance-only or balances including accrued interest?</td></tr>
<tr><td>1(c)</td><td>Exposures that give rise to CCR held in the banking book and trading book (excluding securities financing transactions (SFTs), the exposure at default as measured under APS 180.

With regard to APS 180, at a high level there are inconsistent exposure calculation requirements between APS 180 and APS 221 which contradicts paragraph 1(b) in Attachment A of APS 221. Examples include:
• Offsetting long and short positions in the banking book: paragraphs 15-16 and paragraph 17(b) may be inconsistent with APS 180.
• Paragraph 11: it is not clear what is meant by “absolute market value of the credit protection”. In APS 180 the exposure is a calculation.
• Asset classes, netting sets and hedging sets are not used in APS 221. In APS 180 all derivative transactions are assigned to one asset class. The calculation of exposures is different for each asset class.

In APS 180, ADIs also have the concept of netting sets and hedging sets. Offsetting is permitted within a hedging set. The netting set relates to the formal ISDA/CSA</td><td>The ABA is happy to facilitate a workshop between APRA and ADIs to work through these details.</td></tr>
</table>

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Paragraph	Section	ABA comments
	netting. For call options calculation it appears that the exposure is the market value of the option. For put options the calculation is the strike less the market value (payoff amount). In APS 180 ADIs use these as inputs to the calculation of exposure.	
	Credit risk mitigation	
2	Only those CRM techniques allowed under APS 112 are permitted in reducing large exposure values. Those that are only eligible under APS 113 are not permitted (Paragraph 16 of current standard refers to eligible collateral). According to paragraph 7 "where an ADI has legally enforceable netting arrangements in place for loans and deposits, an ADI must use net credit exposure". This contradicts paragraph 2, where the CRM technique is not allowed, as under APS 112 cash mitigation is not recognised, but allowed under APS 113.	The ABA seeks APRA's confirmation that paragraph 7 will continue to apply in the new standard, so that mitigation against credit loans is allowed where an ADI has legally enforceable netting arrangements in place, e.g. cash mitigation, guarantee mitigation is permitted.
	Offsetting long and short positions in the trading book in the same issue	
14-19		The ABA would welcome additional clarity on the application of paragraphs 14 to 19. In particular: • How should unsettled trades for bonds/floating rate notes etc. be treated in order to avoid duplication with these being considered under paragraph 9, i.e. will unsettled bonds also be measured for counterparty risk? • What is meant by "trading book position"? The intent of the draft standard appears to be gross exposures based on a number of dimensions, while a trading book position is usually the net of the valuation and/or risk exposure. • What is meant by the "default of the respective underlying instrument" in the context of (say) a bank bill? • Paragraph 12 advises on how to treat vanilla options: The ABA seeks clarification on how exotic options are to be treated, e.g. barriers, average rate/strike?

Paragraph	Section	ABA comments
		• The ABA would appreciate a definition of the phrase “component position” in paragraph 12. • The ABA would welcome clarification of the term “decomposed into their individual legs” contained in paragraph 12. In context, this seems to mean the underlying instrument for a derivative, e.g. a bond for a bond future. This is based on paragraph 10 which states “…recognise only those transaction legs for which exposures are not excluded under paragraph 18”. The ABA understands that paragraph 18 is strictly in the context of “issue” which are debt instruments. • The ABA would also appreciate guidance and examples as to how exposures for FX, commodities or repo are to be calculated. These traded product types cannot readily fit into the categories provided. • The ABA would appreciate clarification of the large exposure limits to these trading book categories. We would recommend that the counterpart level is applied for trading book exposures.
	Offsetting long and short positions in the trading book in different issues	
19	Paragraph 19 states “when the result of offsetting in the trading book is a net short position with an individual counterparty, this net short position does not need to be considered as an exposure for the purposes of this Prudential Standard.”	The ABA would welcome APRA’s confirmation that this is in relation to both the issuer and the counterparty. The ABA would also welcome clarification whether this means that ADIs should now ignore all net short positions to an individual counterparty in the trading book.
	Exposure values for structured vehicles	
21	“An ADI must consider an exposure that arises from investment in structured vehicles or vehicles, e.g. funds, securitisation vehicles, structured finance products, which invest in other assets.”	The ABA would welcome clarification on the definition of “funds”. Please clarify that the definition of “structured vehicles” and the reference to “funds” does not intend to include typical banking activities and exposures to third party funds, e.g. superannuation

Paragraph	Section	ABA comments
		funds, but rather a bank's own fund management activities and investments in its own funds.
21	The ABA would argue that decomposing the structured vehicle into its constituent parts via a look-through approach as proposed in paragraph 21 is counterintuitive to why ADIs take on these exposures in the first place (due to their diversification).	The test is also extremely complex and onerous to systemise and monitor on an ongoing basis. The basis to which it should be applied is unclear. The ABA position is that the threshold test should be removed and exposure just simply assigned to the structure. The ABA seeks clarification whether this test is on a proportional basis in line with underlying ownership per cent or only if the holding company controls the underlying asset?
21	The look through test will apply when exposure is >0.25 per cent of Tier 1 Capital. This is a very low threshold, particularly for smaller ADIs which in practice could mean that a large number of structured vehicles/underlying exposures will need to be identified to determine if the look through test should be applied.	The test is also extremely complex and onerous to systemise and monitor on an ongoing basis. The basis to which it should be applied is unclear. The ABA position is that the threshold test should be removed and exposure just simply assigned to the structure, however we accept the test is part of the BCBS standard, therefore APRA could consider altering the test to minimise the impact on smaller ADIs. The ABA would also welcome a clarification whether this test is on a proportional basis in line with underlying ownership per cent or only if the holding company controls the underlying asset?
21	Aggregation of RMBS exposures with exposures to an ADI	RMBS that are repo-eligible with the RBA are not treated as structured exposures. The ABA view is that these exposures are ring-fenced and distinct to the non-RMBS debt exposures an ADI would have to the originator of the mortgages and should not be aggregated, i.e. not treated as a connected counterparty, with exposures to the associated ADI. Furthermore, these securities should be excluded from large exposure determinations given ADIs hold these securities given

Paragraph	Section	ABA comments
		their repo-eligible nature under the CLF and hence assist the ADIs ability to comply with LCR.
21	The BCBS standard clarifies that it is only exposures to investments in the structured vehicle that are relevant, not other types of exposures. For example, an ADI could have exposure as a swap provider or via a liquidity facility to a securitisation and may not be investing in any securities issued in a securitisation. This clarification is critical in particular as it related to the "look through".	As part of the consultation process to finalise APS 221 the ABA recommends that APRA undertakes further engagement with industry to clearly define "investment". As part of that engagement the ABA would welcome APRA's confirmation that banking services and facilities provided to a structured vehicle, e.g. credit exposures/loan facilities and swaps, be treated as an exposure to the structured vehicle itself and the look through would not be required. This is a sensible outcome as these relationships are very distinct to an ADI making an investment in a structured vehicle, in which case, the look through approach to exposures could apply.
21	The inclusion of the term "vehicles" after "structured vehicles" is too broad. There should at the very least be some degree of structuring that is required than simply having an asset investing entity.	The ABA would welcome the opportunity to conduct workshops with APRA to refine and clarify the requirements of the new APS 221 prior to its finalisation and release. The term structured vehicles should take into account hallmarks of a special purpose vehicle, e.g. bankruptcy remoteness, restricted activities and investments, outsourced service providers etc. APRA should work with industry to clearly define "structured vehicles". The ABA proposes that the four specialised lending subclasses defined in paragraph 43 of APS 113 be carved out of the definition of structured vehicles.
21	The use of the term "assets" is too broad. It is conceivable that a structured vehicle may invest in an underlying asset which has no counterparty or credit obligations but has substantial value, e.g. gold bullion, real estate in a REIT or equities held in an equity fund.	The ABA recommends that the term "asset", be replaced with a defined term, e.g. "underlying credit exposures assets" which is defined to mean assets consisting of underlying credit exposures originated by an unrelated third party.
21	Paragraph 13 extends paragraph 21 to include "index positions". It is not clear how paragraph 21 would now apply to an index or any other derivative or synthetic exposure to underlying assets particularly if the assets are not financial in nature.	The ABA would appreciate APRA providing worked examples so that ADIs can meet this obligation in a consistent and effective way.

Paragraph	Section	ABA comments
21	Given the broad nature of "structured vehicles" the potential exists to double count exposures.	Accordingly, the ABA recommends that excluded exposures should be extended to exclude: 1. securities and collateral used to obtain funding via a repurchase agreement with a central bank (including the RBA for the same reason that repo-eligible RMBS are excluded). Essentially these securities are highly liquid and central banks facilitate liquidity in these markets for these securities which negates the onerous obligation to look through; 2. to the extent an exposure in an investment has been mitigated with eligible CRM techniques for large exposure purposes in APS 112. As an ordering matter this exposure should be aggregated with exposures to the CRM provider; 3. to the extent an exposure has been netted in accordance with paragraph 7 of Attachment A of APS 221. As an ordering matter this exposure has been by definition netted, so only the net position should be considered for further look through analysis.
21		Further clarity is sought on the definitions of the types of counterparties and types of exposures that are intended to be covered in this section. The ABA views the current drafting as too vague to accurately apply the large exposures framework in practice. Examples with illustrating the different potential outcomes would be beneficial to understanding the intent of the drafting. The examples should also demonstrate the outcomes when the ADI's exposure to the SPV is due to lending activities and equity investments and the pro-rata determinations when there are other lenders and equity providers. The ABA would also welcome confirmation that the definition of "funds" is intended to capture all types of funds including: • Superannuation, pension, endowment funds • Listed funds - all asset classes including property

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Paragraph	Section	ABA comments
		• Regulated funds - including offshore • Private funds • Private equity funds - all asset classes including property • Other funds - all asset classes The ABA also seeks clarification on the definition of "…structured finance products". Is the definition intended to capture all types of structured finance, as these types of funds would all invest in "other assets"?
21	"Exposures to RBA repo-eligible residential mortgage-backed securities are excluded from being treated as exposures to structured vehicles."	The ABA would welcome clarification as to why is it only RMBS eligible securities, that are to be excluded as ADIs, can also hold other RBA eligible security types as a means of raising cash via the repo market?
21		In regards to the 0.25 per cent threshold level, does it apply at two levels, i.e. at the exposure to the vehicle level and the underlying asset?
21		The ABA would welcome confirmation that the tests of underlying assets exposure values is as a percentage of the ADI's Tier 1 Capital at both the level 1 and 2.
21(a)	The ABA considers that paragraph 21(a) does not correctly reflect the flow chart in the discussion paper or the BCBS large exposure framework standard. The ABA would support APRA aligning paragraph 21(a) with the BCBS standard. The amendment should clarify that it is the value of an ADI's investment in the structured vehicle itself that is being tested as a threshold question not the exposure value of the underlying assets which are dealt with under sub paragraphs (b).	Accordingly the ABA recommends that paragraph 21(a) should be altered to read: "If an ADI's investment in a structured vehicle is less than 0.25 per cent of the ADI's Tier 1 Capital, the nominal amount of the investment must be assigned to the structured vehicle itself, otherwise the ADI will be required to apply the look through approach as set out in sub paragraph (b) below."
21(b)(i)	The ABA considers that paragraph 21(b)(i) does not correctly reflect the flow chart in the discussion paper or paragraph 74 of the BCBS standard.	Therefore the ABA recommends that the word "each" should accordingly be replaced with "an".

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Paragraph	Section	ABA comments
	Paragraph 21(b)(i) seems to apply on an all or nothing approach. The ABA's view of the intent in the BCBS standard was partial look through and aggregation of only those identifiable underlying assets whose exposure value exceeds the threshold of 0.22 per cent.	
21(b)(ii)	Similar to above, the ABA considers that paragraph 21(b)(ii) does not correctly reflect the flow chart in the discussion paper or paragraph 75 of the BCBS standard. The ABA's understanding is that what was intended by the BCBS standard was partial aggregation of unknown counterparty exposures.	Therefore the ABA recommends that the word "each" should accordingly be replaced with "an".
21(b)(ii)	The draft standard requires "unknown exposures" to be aggregated with other unknown exposures.	The ABA recommends that these "unknown exposures" should be assigned to the structure rather than aggregated as a new distinct counterparty. If ADIs are required to create a new distinct counterparty for unidentified assets within the SPV, a new distinct counterparty would be created for each SPV and these new counterparties would not be linked to each other or to the SPV.
21(b)(iii)	The ABA would argue that, technically, this sub paragraph should only apply to allocate the balance of ADI exposures to underlying assets in a structured vehicle not otherwise dealt with by paragraphs (b)(i) and (ii).	The ABA recommends that paragraph 21(b) (iii) be replaced with the words, "the balance of an ADI's exposure value to underlying assets of the structured vehicle not assigned to a counterparty under sub paragraphs (i) or an unknown client under (ii), shall be assigned to the structured vehicle itself."
22	The ABA would welcome a clarification of the phrase "it invests".	Following our earlier comments on 'funds' in paragraph 21, the ABA would welcome some additional clarity on what is required under paragraph 22. The ABA's interpretation of paragraph 22 is that where an ADI undertakes its own funds management activities "it invests" in a structured vehicle rather than capture exposure via lending or other banking facilities to all types of funds.
22	The ABA would welcome a clarification of the exposure value to be assigned to the structured vehicle referred to in paragraph 22.	The ABA recommends that that the nominal amount for derivatives should be the EAD as per Attachment A, paragraph (1)(b).

Paragraph	Section	ABA comments
23	The reference to "all investors ranking pari passu" implies a vehicle with a capital structure, and the "ADI holds" a share in the structured vehicle which also implies an investment.	The ABA would welcome clarification whether paragraph 23 intends to capture "lending" to funds which have members, holds shares, units or contribute capital all typically on a pari passu basis.
24	Reference to "different seniority levels among investors" and "tranches".	Clarification is sought as this is not typical of traditional exposure to funds, rather a vehicle with a capital structure and different "classes" of investors.
24	Reference to "ADI's investment in the tranche".	Clarification is sought as this implies that this is not applicable to traditional funds.
24	The paragraph references an assumption of pro rata losses where investors rank at different seniority levels. The draft APS 221 infers that a loss amount of less than notional is being applied in this instance.	The ABA would welcome further APRA guidance to clarify what assumptions with respect to losses incurred are expected to be utilised.
24	There appears to be a minor cross referencing error in sub paragraph 24. The current cross referencing would make the quantification and testing circular. This also ensures consistency with the BCBS large exposure framework and consistently recognises credit enhancement afforded by trenching in securitisation.	Reference to "21(b)(i)" should be to 24(b). As mechanically paragraph 21(b) relies on calculation of exposure values under paragraphs 23 and 24.
24	Reference to "different seniority levels among investors" and "tranches".	Clarification is sought as this is not typical of traditional exposure to funds, rather a vehicle with a capital structure and different "classes" of investors.
24	Reference to "ADI's investment in the tranche".	Clarification sought as this implies this is not applicable to traditional funds.
26	**Additional risk factor** As discussed in the main submission, aggregation across third parties, and additional risk factors are extremely complex to systemise and monitor which will require significant time and resources to implement. Aggregation will result in the exposure in the structured vehicle being counted multiple times and result in an	The ABA recommends that the requirements in paragraph 26 should be removed entirely. Structured vehicles are generally structured so that each vehicle is segregated, bankruptcy-remote and can continue to function on a stand-alone basis if a particular counterparty does not perform its role satisfactorily by having back-up and/or replacement mechanisms in place.

Paragraph	Section	ABA comments
	exposure to the third party counterparty which could be far in excess of its commitment to the structured vehicle.	Notwithstanding the above recommendation, the ABA has made some further comments on paragraph 26.
26	Repo-eligible RMBS exposures are to be excluded from the structured vehicle treatment, but can be potentially included via paragraph 26 due to the application of the additional risk factor requirements as currently drafted.	The ABA would welcome clarification that these exposures are excluded from the structured vehicle treatment.
26	Paragraph 26 includes the statement "Third parties may include, but are not limited to, fund managers…"	The ABA would welcome APRA's clarification regarding the definition of "fund managers" as the language implies typical securitisation counterparts.
26	For the purpose of look through large exposure aggregation (particularly referencing paragraph 27).	The ABA would welcome clarification on what is the intended aggregation requirement contemplated for originators of securitisation assets financed via an SPV. Similarly, the ABA seeks to understand the principle applied, i.e. how connected counterparties are determined, as it relates to mezzanine debt providers, hedge and liquidity counterparties, LMI or residual value guarantors etc.
26	There is some uncertainty as to whether or not the existence of common third party service providers with non-financial service obligations would necessitate aggregation of exposures in structured vehicles.	In these circumstances the ABA would welcome APRA's confirmation that where such service providers, including originators, may legally be replaced, no aggregation of structured vehicle investments will be necessitated by reason of commonality of service providers.
26-29	Paragraph 26 does not specifically name some entities such as servicers, back-up servicers and trustees that could be identified as contributing an additional risk factor to the structured vehicle. However, none of paragraphs 26 to 29 contain a materiality qualification. Therefore on a literal interpretation of paragraph 26, it would be possible to require aggregation to remote entities such as trustees, which are very unlikely to affect the credit quality of the underlying assets or cause loss to the ADI. The same analysis is true of any service or facility provider to a securitisation.	The ABA proposes that paragraphs 26 to 29 of Attachment A (particularly 26 and 29) are assessed using the economic interdependence criteria set out in paragraph 24 of the draft APS 221. In general, the ABA's view is that a third party should be considered a connected counterparty if its default would result in (or have a material risk of) a default in the ADI's exposure to the structured vehicle. The third party should not be considered connected if they are replaceable.

Paragraph	Section	ABA comments
		The ABA notes that the BCBS standards have generally given some guidance on this matter and suggest that the 221 practice guide could include similar guidance. For example, paragraph 81 of the BCBS standard gives the following example: “But in other cases, the identity of the manager may not comprise an additional risk factor - for example, if the legal framework governing the regulation of particular funds requires separation between the legal entity that manages the fund and the legal entity that has custody of the fund’s assets.” Paragraph 81 of the BCBS standard also states: “Whether the exposures to such structures [structured vehicles] must be added to any other exposures to the third party would again depend on a case-by-case consideration of the specific features of the structure and on the role of the third party.”
27	The footnote (#17) to paragraph 27 states “A third party, such as a fund manager, may not contribute to an additional risk factor if the legal framework of the structured vehicle requires separation between the legal entity managing the fund and the legal entity that has custody of the fund’s assets”.	The footnote could imply aggregation of funds to fund managers. The ABA would welcome confirmation that the paragraph only applies to “structured vehicles” rather than “funds”.
29	Securitisation exposures are typically structured as tax neutral, bankruptcy remote, non-recourse deals to the originator/servicer/trust manager, where service providers can be replaced.	The ABA would welcome clarification whether this now means that all exposures to structured finance vehicles, including securitisation warehouses, interest rate swaps and term investments, must be aggregated together with the corporate facilities of their originator/servicer/trust manager, unless they are RBA repo-eligible RMBS. The ABA notes that the RBA allows for other asset-backed securities to be repo-eligible including ABCP, CMBS, securities backed by auto loans/leases and/or credit card receivables. The ABA would welcome further guidance as to the reasons why these

Paragraph	Section	ABA comments
		other RBA repo-eligible asset-backed securities have not been treated the same as RBA repo-eligible RMBS.
	Reporting Standard ARS 221.0 Large Exposures	
	Reporting periods and due dates	
10	The proposed ARS 221 must be provided to APRA within 28 calendar days after the end of the reporting period. However, this does not align with ARF 110.0.1 and ARF 110.0.2, which are due within 30 business days after the end of the reporting period. This inconsistency would be problematic as there is a data interdependency between the forms.	As discussed in the main part of this submission the ABA recommends that the ARS 221 reporting due dates be aligned with ARF 110.0.1 and ARF 110.0.2.
	ARF 221.0 Large Exposures – Reporting Form	
2. Table	Groups of connected counterparties table	The ABA recommends that sub group names be used instead of listing all of the names of individual connected counterparties.
	ARF 221.0 Large Exposures – Instruction Guide	
	The proposed ARS 221 requires an ADI to report the counterparty sector of the exposure reported under item 1. There are 12 counterparty sectors specified in the proposed ARS 221.	The ABA would welcome APRA's clarification whether these counterparty sectors required under the proposed ARS 221 can be based on either the ANZSIC code or SESCA. This would align to other changes, such as the EFS.