



# Banking (prudential standard) determination No. 5 of 2014

## Prudential Standard APS 221 Large Exposures

### *Banking Act 1959*

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I, Wayne Byres, delegate of APRA:

- (a) under subsection 11AF(3) of the *Banking Act 1959* (the Act) REVOKE Banking (prudential standard) determination No. 13 of 2012 including *Prudential Standard APS 221 Large Exposures* made under that Determination; and
- (b) under subsection 11AF(1) of the Act DETERMINE *Prudential Standard APS 221 Large Exposures* in the form set out in the attached Schedule, which applies to ADIs and authorised NOHCs to the extent provided in paragraphs 2 to 5 of the prudential standard.

This instrument takes effect on 1 January 2015.

Dated: 3 December 2014

[Signed]

Wayne Byres  
Chair

### **Interpretation**

In this instrument:

*ADI* has the meaning given in section 5 of the Act.

*APRA* means the Australian Prudential Regulation Authority.

*authorised NOHC* has the meaning given in section 5 of the Act.

## **Schedule**

*Prudential Standard APS 221 Large Exposures* comprises the 7 pages commencing on the following page.



## **Prudential Standard APS 221**

### **Large Exposures**

#### **Objective and key requirements of this Prudential Standard**

This Prudential Standard requires authorised deposit-taking institutions to implement prudent measures and to set prudent limits to monitor and control their large exposures, on both a Level 1 and Level 2 basis.

## Authority

1. This Prudential Standard is made under section 11AF of the *Banking Act 1959* (**Banking Act**).

## Application

2. This Prudential Standard applies to all **authorised deposit-taking institutions (ADIs)**, subject to paragraph 3.
3. This Prudential Standard does not apply to:
  - (a) **purchased payment facility providers (PPF providers)**; or
  - (b) **foreign ADIs** in Australia that are subject to consolidated supervision by their home country supervisors in respect of credit concentrations and large exposure limits. However, foreign ADIs must detail their large exposure and risk concentration policies as well as the relevant high level controls in the **risk management strategy** required under *Prudential Standard CPS 220 Risk Management* (CPS 220). As part of its prudential oversight of the Australian operations of a foreign ADI, APRA may discuss with the foreign ADI's parent and home supervisor any undue credit risk concentrations associated with the foreign ADI's Australian activities.
4. A reference to an ADI in this Prudential Standard, unless otherwise indicated, is a reference to:
  - (a) an ADI on a **Level 1** basis; and
  - (b) a **group** of which an ADI is a member on a **Level 2** basis.
5. If an ADI to which this Prudential Standard applies is:
  - (a) the holding company for a group, the ADI must ensure that the requirements in this Prudential Standard are met on a Level 2 basis, where applicable; or
  - (b) a subsidiary of an authorised **non-operating holding company (authorised NOHC)**, the authorised NOHC must ensure that the requirements in this Prudential Standard are met on a Level 2 basis, where applicable.

## Interpretation

6. Terms that are defined in *Prudential Standard APS 001 Definitions* appear in bold the first time they are used in this Prudential Standard.

## Control of large exposures and risk concentrations

7. An ADI is exposed to various forms of risk concentration with the potential to incur significant losses that could materially threaten the ADI's financial

strength. Risk concentrations may arise from excessive exposures to individual counterparties, groups of related counterparties, groups of counterparties with similar characteristics (e.g. counterparties in specific geographical regions or industry sectors) or to particular asset classes (e.g. property holdings or other investments). Safeguarding against risk concentrations to particular counterparties,<sup>1</sup> industries, countries and asset classes must form an essential component of an ADI's risk management strategy required under CPS 220.

8. The Board of directors (**Board**) of an ADI is responsible for establishing, and monitoring compliance with, policies governing large exposures and risk concentrations of the ADI. The Board must ensure that these policies are reviewed regularly (at least annually) and that they remain adequate and appropriate for the ADI. Any material changes to established policies must be approved by the Board.
9. An ADI's large exposures policy must, as a minimum, cover the following:
  - (a) exposure limits for:
    - (i) various types of counterparties (e.g. governments, ADIs and foreign equivalents, corporate and individual borrowers);
    - (ii) a group of related counterparties;
    - (iii) individual industry sectors (where applicable);
    - (iv) individual countries (where applicable); and
    - (v) various asset classes (e.g. property holdings and other investments, etc.)

that are commensurate with the ADI's capital base and balance sheet size;
  - (b) the circumstances in which the above exposure limits may be exceeded and the authority required for approving such excesses (e.g. by the ADI's Board or a board committee); and
  - (c) the procedures for identifying, reviewing, controlling and reporting large exposures of the ADI.
10. The Board and senior management of an ADI must ensure that:
  - (a) adequate systems and controls are in place to identify, measure, monitor and report large exposures and risk concentrations of the ADI in a timely manner; and
  - (b) large exposures and risk concentrations of the ADI are regularly reviewed.

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<sup>1</sup> As a general rule, unlimited exposure to any individual counterparty (e.g. a general guarantee of the obligations of a counterparty) is not permitted.

11. An ADI must, where appropriate, conduct stress testing and scenario analysis of its large exposures and risk concentrations to assess the impact of changes in market conditions or key risk factors (e.g. economic cycles, interest rate, liquidity conditions or other market movements) on its risk profile and earnings.

## Definitions

12. A large exposure is an exposure to a counterparty or a group of related counterparties which is greater than or equal to 10 per cent of an ADI's **Regulatory Capital**<sup>2</sup>.
13. An exposure to a counterparty or a group of related counterparties is the aggregate of all claims, commitments and contingent liabilities arising from on- and off-balance sheet transactions (in both the banking and trading books) with the counterparty or group of related counterparties, and:
  - (a) includes, but is not limited to:
    - (i) outstanding balances of all loans and advances;
    - (ii) holdings of debt and/or equity securities;
    - (iii) all unused advised off-balance sheet commitments (refer to Attachment B to *Prudential Standard APS 112 Capital Adequacy: Standardised Approach to Credit Risk* (APS 112)), whether revocable or irrevocable; and
    - (iv) the credit equivalent amounts of all market-related contracts (calculated in accordance with Attachment B to APS 112 or Attachment J to APS 112 where netting applies)<sup>3</sup>;
  - (b) excludes:
    - (i) exposures (e.g. claims or equity investments) deducted from an ADI's Regulatory Capital (refer to *Prudential Standard APS 111 Capital Adequacy: Measurement of Capital*);
    - (ii) exposures to the extent that they are secured by cash deposits (subject to satisfying all the criteria applicable to transactions collateralised by cash as set out in Attachment H to APS 112 for the purpose of this Prudential Standard);
    - (iii) exposures to the extent that they are guaranteed by, or secured against securities issued by governments or central banks (being the

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<sup>2</sup> The 10 per cent threshold applies to an ADI's exposure at both Level 1 and Level 2 on a net basis (i.e. net of exposures excluded under paragraph 13).

<sup>3</sup> For large exposure purposes, netting by novation and close-out netting are permissible for market-related contracts provided all the requirements set out in Attachment J to APS 112 for bilateral netting are met. Multilateral netting and netting of exposures against offsetting positions held by a group of related counterparties are not recognised for the purposes of this Prudential Standard.

Australian government, foreign governments and central banks which receive a zero per cent risk-weight in accordance with Attachment A to APS 112 for the purpose of this Prudential Standard);

- (iv) exposures arising in the course of settlement of market-related contracts;
  - (v) exposures to an ADI required as part of an industry support contract relating to liquidity that has been certified by APRA under section 11CB of the Banking Act; and
  - (vi) exposures to the extent that they have been written off or specifically provided for.
14. A group of related counterparties is deemed to exist where two or more individual counterparties are linked by:
- (a) cross guarantees;
  - (b) common ownership or management;
  - (c) the ability to exercise control over the other(s), whether direct or indirect;
  - (d) financial interdependency such that the financial soundness of any of them may affect the financial soundness of the other(s); or
  - (e) other connections or relationships which, according to an ADI's assessment, identify the counterparties as constituting a single risk.

As a general rule, family members are not to be treated as connected where they have independent retail relationships with an ADI (although an ADI may choose to treat such exposures as connected if it considers it appropriate to do so).

### **Prudential limits**

15. The aggregate exposure of an ADI to a counterparty or a group of related counterparties is subject to the following limits<sup>4</sup>:
- (a) external parties (other than governments, central banks and ADIs or equivalent overseas deposit-taking institutions) unrelated to the ADI – 25 per cent of Regulatory Capital;
  - (b) unrelated ADI (or equivalent overseas deposit-taking institution) and its subsidiaries – 50 per cent of Regulatory Capital, with aggregate exposure to non-deposit-taking subsidiaries capped at 25 per cent of Regulatory Capital; and

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<sup>4</sup> These limits apply to an ADI's exposure at both Level 1 and Level 2 on a net basis.

- (c) foreign parents and their subsidiaries<sup>5</sup> – 50 per cent of Regulatory Capital, with aggregate exposure to non-deposit-taking subsidiaries capped at 25 per cent of Regulatory Capital.
16. Although certain types of exposure (e.g. settlement risk, exposure secured by eligible collateral) and counterparties (governments and central banks) are excluded from the above prescribed limits, these exposures are not risk-free. An ADI must have adequate procedures and controls in place (e.g. by way of internal limits) to monitor these exposures.
17. An ADI must treat the 25 per cent limit as the upper limit for an exposure to a non-government, non-ADI counterparty. APRA expects an ADI to establish lower internal limits to any non-government, non-ADI counterparty commensurate with their risk appetite.
18. Notwithstanding paragraph 15, APRA may, in writing, set specific limits on an ADI's exposures to particular counterparties, groups of counterparties, industry sectors, countries or asset classes, including property holdings and any other investments, on a case-by-case basis, having regard to the ADI's individual circumstances.

### **Approval requirements**

19. An ADI must obtain APRA's prior approval for any proposed exposures in excess of the prescribed limits set out in paragraph 15 or alternative limit determined under paragraph 18. Such approval will only be granted on an exceptions basis. The ADI concerned must be able to satisfy APRA why the proposed exposure(s) might reasonably be expected not to expose the ADI to excessive risk. APRA may impose a higher minimum capital ratio on the ADI at Level 1 and/or Level 2 to compensate for the additional risk that may be associated with the proposed exposures.

### **Notification requirements**

20. An ADI must notify APRA immediately of any breach of the prescribed limits under paragraph 15 or other specific limits imposed by APRA under paragraph 18, including remedial actions taken or planned to deal with the breach.
21. An ADI must inform APRA immediately where it has concerns that its large exposures or risk concentrations have the potential to impact materially upon its capital adequacy, along with proposed measures to address these concerns.

### **Prior consultation requirements**

22. An ADI must consult with APRA prior to committing to any proposed exposures to non-government, non-ADI counterparties in excess of 10 per cent of its Regulatory Capital<sup>6</sup>.

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<sup>5</sup> Prudential limits on an ADI's exposures to other related entities are set out in *Prudential Standard APS 222 Associations with Related Entities*.



23. APRA may, in writing, set a higher consultation threshold or waive the prior consultation requirements for individual ADIs where APRA is satisfied with the robustness of the ADI's credit risk management systems and controls.

### **Concentration of risk**

24. Where an ADI has a number of large exposures (excluding exposures set out in paragraph 13(b) and any exposure to governments and central banks) or where, in APRA's opinion, the ADI is exposed to a significant level of risk concentration, APRA may require the ADI to maintain a higher capital ratio at Level 1 and/or Level 2. In considering whether an ADI's capital ratio should be increased, APRA will take account of the following factors:
  - (a) consistency with the ADI's policy on large exposures and risk concentrations;
  - (b) the number of exposures, their individual size and nature; and
  - (c) the characteristics of the ADI, including the nature of its business and the experience of its management.
25. APRA may also direct an ADI to take measures to reduce its level of risk concentration.

### **Adjustments and exclusions**

26. APRA may, by notice in writing, adjust or exclude a specific prudential requirement in this Prudential Standard in relation to one or more specified ADIs or authorised NOHCs<sup>7</sup>.

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<sup>6</sup> The 10 per cent prior consultation requirement applies to any proposed exposures of an ADI at both Level 1 and Level 2 on a net basis (i.e. net of exposures excluded under paragraph 13 above). The ADI's regulatory capital at Level 1 and Level 2 is measured in accordance with APS 111.

<sup>7</sup> Refer to sub-section 11AF(2) of the Banking Act.