

Banking (prudential standard) determination No. 4 of 2015

EXPLANATORY STATEMENT

Prepared by the Australian Prudential Regulation Authority (APRA)

Banking Act 1959, section 11AF

Under subsection 11AF(1) of the *Banking Act 1959* (the Act), APRA has the power to determine standards (prudential standards), in writing, in relation to prudential matters to be complied with by authorised deposit-taking institutions (ADIs) and authorised non-operating holding companies (authorised NOHCs). Under subsection 11AF(3) of the Act, APRA may, in writing, vary or revoke a prudential standard.

On 14 December 2015, APRA made Banking (prudential standard) determination No. 4 of 2015, which revokes *Prudential Standard APS 110 Capital Adequacy* made under Banking (prudential standard) determination No. 1 of 2015, and determines a new *Prudential Standard APS 110 Capital Adequacy* (APS 110).

The instrument commences on 1 January 2016.

1. Background

APRA regulates banking, insurance and superannuation entities with the aim of ensuring that they can meet their financial promises to depositors, policyholders and superannuation fund members within a stable, efficient and competitive financial system. APRA seeks to fulfil this mandate through an authorisation process, and ongoing supervision of ADIs under a prudential framework consisting of guidance and mandatory rules. APRA also supervises and regulates with the aim of promoting financial system stability in Australia.

APRA's prudential framework for ADIs is based on the framework agreed by the Basel Committee on Banking Supervision (Basel Committee). In 2012, APRA implemented measures developed by the Basel Committee that were intended to further strengthen this framework to address deficiencies identified during the global financial crisis. These reforms, known as 'Basel III', included two new capital buffers to apply to ADIs, the capital conservation buffer and the countercyclical capital buffer, which come into effect on 1 January 2016.

The purpose of the countercyclical capital buffer is to raise banking sector capital requirements in periods of excess credit growth, which have often been associated with the build-up of systemic risk. This additional buffer can then be released during periods of stress, to reduce the risk of the supply of credit being constrained by regulatory capital requirements.

The buffer framework is also designed to ensure that the application of the buffer in a given jurisdiction does not distort the level playing field between domestic banking institutions and foreign banking institutions with exposures to counterparties in the same jurisdiction. The buffer that will apply to an ADI with private sector credit exposures in other jurisdictions is calculated as the weighted average of the buffers applying in each of these jurisdictions.

2. Purpose and operation of the instrument

The purpose of the instrument is to revoke APS 110 and replace it with an amended version of the prudential standard.

The instrument amends the wording in APS 110 to clarify the intended operation of the countercyclical capital buffer. In particular, it seeks to avoid confusion by clearly separating the ‘ADI-specific’ and ‘Australian jurisdictional’ elements of the buffer mechanism. APRA’s stated policy during consultation was that APRA would determine the countercyclical capital buffer for the Australian jurisdiction, whereas the ADI-specific countercyclical capital buffer, which also takes account of private sector credit exposures in other jurisdictions, was to be calculated in accordance with Attachment C. The amendments also more clearly define the exposures used to calculate the ADI-specific countercyclical capital buffer and address an ambiguity about the circumstances under which an ADI must consult with APRA over the geographic allocation of some of its trading book exposures.

3. Consultation

APRA initially consulted on the countercyclical capital buffer as part of its consultation on the implementation of Basel III in Australia. Five submissions were received, from ADIs, industry bodies and other interested parties. The primary concern raised in these submissions was the proposed application of the countercyclical capital buffer to all banking institutions, including those that may not have contributed to, or benefitted from, any excess credit growth giving rise to a non-zero buffer rate. In two papers in response to these submissions, APRA confirmed that the countercyclical capital buffer would apply to all ADIs in Australia (other than providers of purchased payment facilities that are not subject to many aspects of Basel III).

In September 2015, APRA sought submissions on its proposed amendments to APS 110 to clarify the operation of the countercyclical capital buffer. APRA received one submission from an industry association and subsequently held discussions with the association and representatives of its members. In response to issues raised in the submission and these discussions, further refinements were made to the intended amendments to APS 110 to more clearly delineate the jurisdictional and ADI-specific elements of the countercyclical capital buffer framework.

4. Regulation Impact Statement

The Office of Best Practice Regulation has advised that a Regulation Impact Statement is not required to correct a potential ambiguity.

5. Statement of compatibility prepared in accordance with Part 3 of the Human Rights (Parliamentary Scrutiny) Act 2011

A Statement of Compatibility prepared in accordance with Part 3 of the *Human Rights (Parliamentary Scrutiny) Act 2011* is provided at Attachment A to this Explanatory Statement.

ATTACHMENT A

Statement of Compatibility with Human Rights

Prepared in accordance with Part 3 of the Human Rights (Parliamentary Scrutiny) Act 2011

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The instrument is compatible with the human rights and freedoms recognised or declared in the international instruments listed in section 3 of the *Human Rights (Parliamentary Scrutiny) Act 2011* (HRPS Act).

Overview of the Legislative Instrument

The purpose of the instrument is to revoke *Prudential Standard APS 110 Capital Adequacy* and replace it with an amended version of the prudential standard. APS 110 sets out the regulatory capital requirements applying to authorised deposit-taking institutions (ADIs), which are bodies corporate authorised by the Australian Prudential Regulation Authority (APRA) to carry on banking business in Australia. APS 110 includes a requirement whereby ADIs may be required to hold additional capital as a countercyclical capital buffer, which aims to build capital buffers that can be used in times of stress and to achieve the broader macroprudential goal of protecting the banking system from periods of excess credit growth. The instrument makes minor amendments to APS 110 to clarify operational aspects of the countercyclical capital buffer framework that is to commence on 1 January 2016.

Human rights implications

APRA has assessed the instrument and is of the view that it does not engage any of the applicable rights or freedoms recognised or declared in the international instruments listed in section 3 of the HRPS Act. Accordingly, in APRA's assessment, the instrument is compatible with human rights.

Conclusion

The instrument is compatible with human rights as it does not raise any human rights issues.