HOUSE OF REPRESENTATIVES STANDING COMMITTEE ON ECONOMICS

REVIEW OF THE FOUR MAJOR BANKS (SECOND REPORT)

Westpac

Westpac16QON: Hansard Page 32

Mr HOGAN: Just on a technical point here, are you allowed to buy other assets besides Commonwealth government bonds for that liquidity?

Mr Hartzer: There may be some other small categories, but effectively no.

Mr HOGAN: You are saying there is no other—

Mr Hartzer: I will take the detail of that on notice, but overwhelmingly, essentially, it is Australian Commonwealth government bonds or the CLF, and that is it.

Mr HOGAN: You are saying that there is no other alternative but to use this facility?

Mr Hartzer: My understanding is that at one point buying other countries' government bonds in return was looked at, but with the currency risks and so on associated with that they were viewed as not an adequate response. It is a pretty technical issue, and I am happy to come back to you, but the premise of your question is: are we simply doing this because of the cost? No, I would not accept that premise. This is a structural fundamental of the way the Australian economy works. It is one of the reasons why we have large banks. They have to have balance sheets that are strong enough for us to go to overseas markets and raise funding on a continuous basis so that we can support the Australian economy.

Answer: A key component of the Basel Committee's global framework for promoting stronger liquidity buffers at financial institutions is the Liquidity Coverage Ratio (LCR).

The LCR requires banks to hold sufficient high-quality liquid assets (HQLA) to withstand a 30-day severe stress scenario, as defined by APRA.

In Australia, the only assets qualifying as HQLA are Australian Government Securities (AGS), securities issued by the borrowing authorities of the states and territories (semis) and liabilities of the RBA, being cash and Exchange Settlement funds.

In Australia, fiscal prudence by a succession of governments means that the supply of government securities in Australia is relatively limited.

Instead, the RBA and APRA introduced the CLF. This kind of alternative liquidity approach was made available by the Basel Committee to jurisdictions that have an

insufficient supply of HQLA, such as Australia. The RBA offers the CLF in Australia on contractual terms and conditions that are consistent with the Basel III liquidity framework.

Banks must apply each year to APRA for an allocation of CLF. Amongst other things, APRA requires that banks "demonstrate that they have taken 'all reasonable steps' towards meeting their LCR requirements through their own balance sheet management before applying for a CLF for LCR purposes."

Westpac was granted a CLF of $66 billion for the 2015 calendar year. This reduced to $58.6 billion in 2016 and $49.1 billion in 2017. In response, Westpac has been increasing its holdings of HQLA and improving its balance sheet liquidity management.

In order to comply with the LCR, and without the Committed Liquidity Facility (CLF), banks would have to shrink their balance sheets to a size where the available HQLA would allow compliance with the LCR calculation. They would also need to hold most of the HQLA on issue.

As noted by the RBA in their outline of Domestic Market Operations "Compelling ADIs to acquire most of the stock of Australian Government Securities (AGS) and semis would very likely interfere with the properties of the market that qualified it as HQLA in the first place; namely, its depth and liquidity."[1]

Collateral for the CLF includes "all debt securities accepted for the Reserve Bank's market operations, including high-quality, Australian dollar-denominated supranational and foreign government debt, and certain related-party debt securities such as self-securitised residential mortgage-backed securities. APRA expects banks to avoid concentrations in CLF-eligible debt securities by type, issuer, credit quality and tenor".[2]

The fee for the undrawn CLF has been set by the RBA at 15bps, payable monthly in advance. As noted by RBA and APRA, "The commitment fee is intended to leave participating ADIs with broadly the same set of incentives to prudently manage their liquidity as their counterparts in jurisdictions where there is an ample supply of high-quality liquid assets in their domestic currency."[3] A single fee applies to all institutions accessing the facility.

[1] RBA outline of Domestic Market Operations, http://www.rba.gov.au/mkt-operations/dom-mkt-oper.html
[2] RBA Financial Stability Review March 2015 available at http://www.rba.gov.au/publications/fsr/2015/mar/pdf/box-a.pdf
[3] APRA and RBA joint media release, 17 December 2010, http://www.apra.gov.au/MediaReleases/Pages/10_27.aspx