The Committed Liquidity Facility

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Abstract

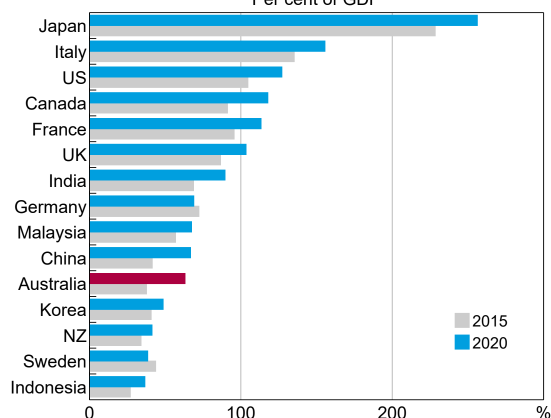
The Reserve Bank provides the Committed Liquidity Facility (CLF) to enhance the resilience of the banking system in times of liquidity stress. Banks need to hold high-quality liquid assets (HQLA), including government securities, as a buffer against liquidity stress. However the low level of government debt in Australia limited the amount they could reasonably hold. The CLF was introduced in 2015 as an alternative. Since 2019, the size of the CLF has been reduced because the amount of government debt on issue has increased significantly. The fee charged for access to the CLF has also been increased to ensure that banks have an incentive to manage their liquidity risk appropriately. The size of the CLF and the associated fee have been adjusted in a measured way to ensure a smooth transition.

The Committed Liquidity Facility (CLF) is a commitment by the Reserve Bank to provide funds to certain authorised deposit-taking institutions (ADIs or 'banks') in a period of liquidity stress.[1] These funds are secured by high-quality collateral. The Reserve Bank provides the CLF as part of Australia's implementation of the Basel III liquidity standard. This framework has been designed to improve the banking system's resilience to periods of liquidity stress. In particular, the liquidity coverage ratio (LCR) requires banks to have enough high-quality liquid assets (HQLA) to cover their net cash outflows (NCOs) in a 30-day liquidity stress scenario. Under the Basel III liquidity standard, jurisdictions with a clear shortage of domestic-currency HQLA can use other approaches to enable financial institutions to satisfy the LCR. These other approaches include the central bank offering a CLF. A per annum fee is charged based on the size of the Reserve Bank's commitment through the CLF to the LCR bank, regardless of whether the bank draws down on the facility or not. The Australian Prudential Regulation Authority (APRA) is responsible for administering the LCR in Australia, and incorporates the CLF provided by the Reserve Bank.[2]

The CLF was introduced because of the low level of government debt in Australia

HQLA are assets that banks can easily use to cover their short-term liquidity needs. To be considered HQLA, securities need to have a low risk profile (high-quality) and be traded in an active and sizeable market (i.e. they need to be liquid; that is, easily exchanged for cash). The only Australian dollar securities that have been assessed by APRA to be HQLA are Australian Government Securities (AGS) and securities issued by the central borrowing authorities of the states and territories (semis).[3] The only other bank assets recognised as HQLA are liabilities of the Reserve Bank, namely banknotes and surplus Exchange Settlement Account (ESA) balances.[4][5]

Historically, the supply of AGS and semis has not been sufficient for banks to meet the LCR requirement. This reflects the relatively low level of government debt in Australia. Australian Government debt equated to around 40 per cent of GDP when the CLF was introduced in 2015, although it has since risen to be around 65 per cent of GDP at the end of 2020 (Graph 1). In 2015, banks would have had to hold around two-thirds of the value of all AGS and semis outstanding to meet LCR requirements. If banks had held that share of these securities, it would have reduced these securities' market liquidity to the extent that they could no longer be considered HQLA, defeating the purpose of holding them.



To avoid being required to hold high levels of AGS and semis that would potentially impair the liquidity of these critical markets, banks subject to the LCR requirement were permitted to establish a CLF with the Reserve Bank. Through the CLF, the Reserve Bank makes a commitment to provide liquidity to cover the shortfall between a bank's 'reasonable' holdings of HQLA (i.e. the amount that can be held without impairing market liquidity) and the LCR requirement. Banks can access this committed amount of liquidity should it be required in a period of liquidity stress. Banks pay a fee that is charged on the entire committed amount, regardless of whether it is drawn. High-quality securities are required as collateral to access the CLF.

APRA determines which banks can establish a CLF with the Reserve Bank. Access is limited to those locally incorporated banks that are subject to the LCR requirement. Before establishing a CLF, a bank must apply to APRA for approval, and demonstrate that every reasonable effort has been made to manage liquidity risk independently rather than relying on the CLF. To access the CLF (that is, to draw on CLF funds), a bank must make a formal request to the Reserve Bank that includes an attestation from the CEO that the bank has positive net worth. The bank must also have positive net worth in the opinion of the Reserve Bank. Since the CLF was established, no bank has ever needed to draw on it for liquidity purposes in a period of financial stress.[6]

APRA has recently approved reductions to the size of the CLF …

The total size of the CLF is the difference between the liquidity requirements of CLF banks, and the HQLA securities that the Reserve Bank assesses that CLF banks can 'reasonably' hold to fulfil these requirements without impairing bond market liquidity. The liquidity requirements of individual CLF banks are assessed by APRA. The requirements include an allowance for banks to have buffers over the minimum requirement of covering 100 per cent of their total projected NCOs over a 30-day period. The requirements also take account of banks' projected holdings of other HQLA (banknotes,

Table 1: Reasonable Holdings of HQLA Securities and the Committed Liquidity Facility

$A billion

	Projection of HQLA securities outstanding*	Locally incorporated CLF banks		
		Reasonable holdings of HQLA securities*	LCR requirements*	CLF Amount**
2015	700	175	449	274
2016	780	195	441	246
2017	880	220	437	217
2018	905	226	474	248
2019	898	225	468	243
1 Jan 2020	934	243	466	223
1 Dec 2020	1340	362	550	188
1 February 2021	1488	446	588	142
1 April 2021	1488	446	585	139

Sources: APRA; RBA

* The RBA's 'Projection of HQLA Securities outstanding' and assessment of 'Reasonable holdings of HQLA securities' for the end of the referenced calendar year. 'LCR requirements' refers to APRA's assessment of the aggregate Australian dollar NCOs for the locally incorporated LCR banks at the end of the calendar year, including an allowance for the banks to have buffers over the minimum LCR requirement of 100 per cent; it also takes into account banks' projected holding of banknotes and surplus ESA balances.

** The CLF Amount applying from the start of the referenced calendar year or where a particular date is specified, from that date. 'CLF Amount' is the difference between the LCR requirements and reasonable holdings of HQLA securities.

surplus ESA balances and undrawn Term Funding Facility (TFF) allowances while they are available).

From the introduction of the CLF in 2015 until 2019, APRA adjusted the size of the CLF from the beginning of each calendar year on the basis of estimates of its required size in the year ahead (Table 1). As part of this process, in mid June the Reserve Bank would publish its estimate of reasonable holdings of AGS and semis for December of the following year. APRA would then ask CLF banks to produce a forecast of their Australian dollar-denominated NCOs and HQLA holdings, and thus their requested CLF amount, for the following calendar year. In 2020, however, large changes in the stock of government bonds outstanding and changes in bank funding and liquidity led APRA to adjust the size of the CLF in a number of steps over 2020 and 2021. Overall, the size of the CLF has declined from $274 billion in 2015 to $139 billion in April 2021. Nearly two-thirds of this decline occurred from 1 December 2020.

… because the level of government debt increased following the COVID-19 outbreak …

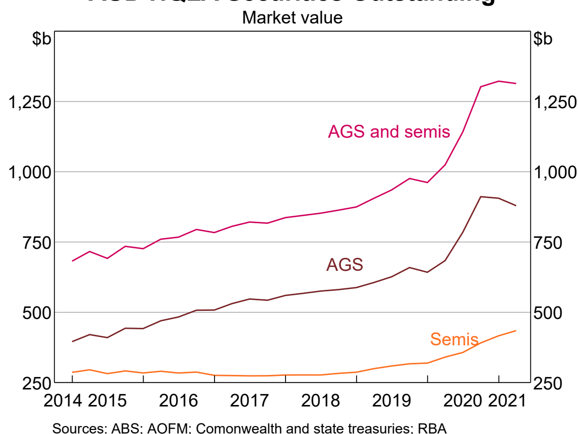
The significant reduction in the overall size of the CLF from 1 December 2020 reflects, in part, the sharp increase in the stock of AGS and semis outstanding as a result of increased issuance to finance the government's economic support measures in response to the COVID-19 pandemic (Graph 2). The increase in the stock of AGS and semis outstanding has meant that banks could hold more of these securities – both in absolute value and as a share of stock outstanding – without unduly affecting market functioning. Indeed, CLF banks' holdings of HQLA securities increased substantially over 2020, with increases in holdings of both AGS and semis during the year, although only semis holdings remained higher at the end of 2020 (Graph 3). As a result, the size of the CLF required to cover the shortfall between banks' holdings of HQLA and their LCR requirements declined.

From 2015 to 2019, the Reserve Bank had assessed that CLF banks could reasonably hold 25 per cent of the stock of AGS and semis outstanding. Following a review of the CLF in 2019, the Reserve Bank had assessed that the share of the stock of HQLA securities that could be reasonably held by CLF banks could increase at a pace of 1 percentage point per year from 25 per cent in 2019 to 30 per cent in 2024. This reflected the increase in the stock of AGS and semis outstanding over time, as well as the fact that they had become more readily available in the market.[7]

Following the sharp increase in the stock of AGS and semis outstanding in 2020, however, the Reserve Bank assessed that the increase in the share of AGS and semis that banks could reasonably hold could occur more quickly. The Reserve Bank assessed that the share of the stock of HQLA securities that could be reasonably held by CLF banks could increase from 26 to 27 per cent of the stock outstanding by the end of 2020, and from 27 to 30 per cent of the stock outstanding by the end of 2021.[8]

Graph 2

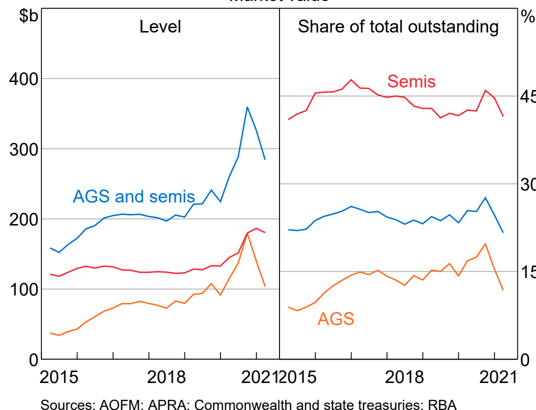
AUD HQLA Securities Outstanding



Sources: ABS; AOFM; Comonwealth and state treasuries; RBA

Graph 3

CLF Banks' Holdings of AUD HQLA Securities



Sources: AOFM; APRA; Commonwealth and state treasuries; RBA

… and because of improvements in funding and liquidity conditions for banks

The reduction in the CLF was also facilitated by improvements in funding and liquidity conditions for banks, where CLF banks were comfortably exceeding their LCR requirements. The policy measures implemented by the Reserve Bank to cushion the Australian economy from the effects of the COVID-19 crisis contributed to the improvement in liquidity conditions in the banking system and lower funding costs across the economy.

Surplus ESA balances held with the Reserve Bank, which are a form of HQLA, have also risen substantially since early 2020 (Graph 4). Funding provided by the Reserve Bank under the TFF has contributed to the rise in ESA balances. The Reserve Bank's purchases of government bonds to support the 3-year Australian Government bond yield target, to aid market functioning, and as part of the Bond Purchase Program (BPP) have also contributed to higher surplus ESA balances.[9] The rise in surplus ESA balances, all else being equal, implies less need for the CLF. However, it is important to note that the level of ESA balances will continue to depend on (and change with) monetary policy developments. Indeed, given the generally uncertain environment in 2020, APRA took a measured approach to reducing the size of the CLF for 2021 (see below).

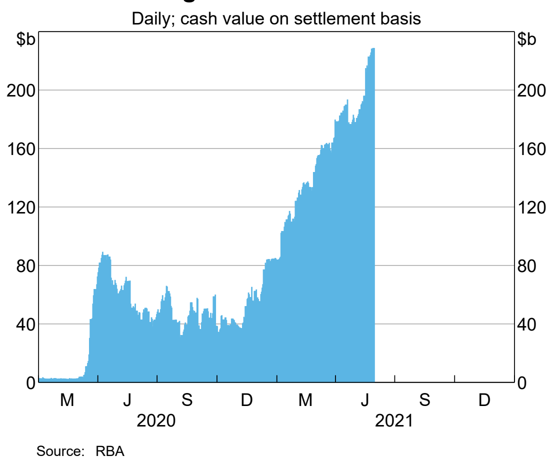
Since November 2020, the Reserve Bank's bond purchases through the BPP have contributed to the increase in ESA balances (Graph 5). Some of these bonds have been purchased from CLF banks, as reflected in the decline in CLF banks' holdings of AGS and semis since late 2020. When the Reserve Bank buys bonds from a bank, it pays for the bonds by crediting that bank's ESA. In other words, one type of HQLA is swapped for another, and the level of HQLA held by the bank stays the same.

At the same time that there has been a large increase in available HQLA over the past year, banks' liquidity needs have increased, owing to a sharp increase in bank deposits over 2020. The increase in deposits has been associated with an increase in NCOs under the LCR scenario, thereby increasing the amount of HQLA required to be held under the LCR requirement (Graph 6). The increase in CLF banks' holdings of HQLA was even larger, however, resulting in the reductions in the required size of the CLF.

Graph 4

Exchange Settlement Balances

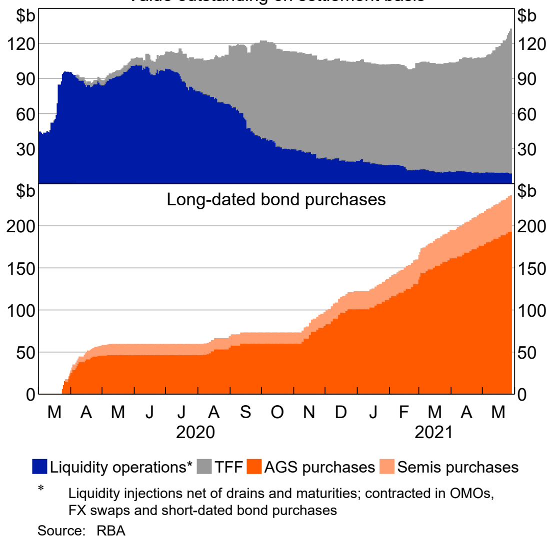
Daily; cash value on settlement basis



Graph 5

Monetary Policy Operations

Value outstanding on settlement basis



Reductions to the CLF have been made in measured steps

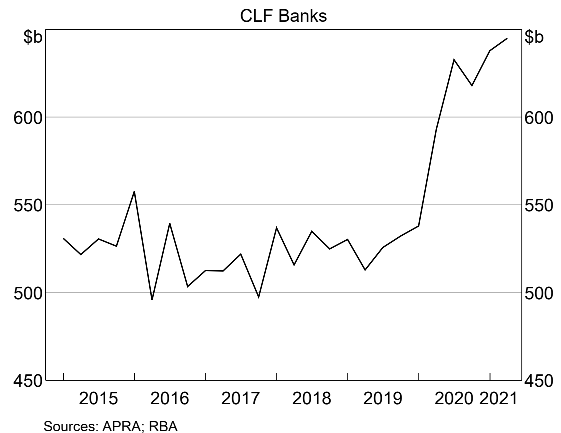
To help banks manage their LCRs in light of the changes in HQLA and NCOs in 2020, APRA allowed CLF banks to apply for interim adjustments to CLF allowances, in addition to the usual annual review process. The overall CLF was accordingly reduced by $35 billion on 1 December 2020, by $46 billion on 1 February 2021, and by a further $3 billion on 1 April 2021 (Graph 7). The CLF now stands at $139 billion, compared with $243 billion in 2019.

APRA has ensured that changes to the CLF continue to be made in a measured way to avoid financial market disruptions. With a smaller-sized CLF, banks need to hold less assets to collateralise their CLF allowances. An overly rapid adjustment to banks' asset holdings has the potential to be disruptive for

Graph 6

Net Cash Outflows

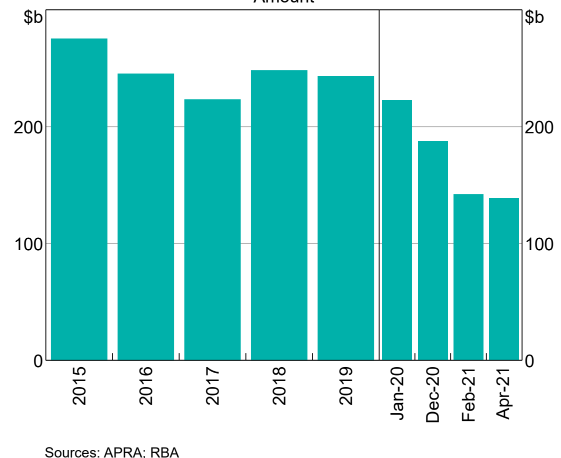
CLF Banks



Graph 7

Committed Liquidity Facility

Amount



both the banks involved and the markets for these assets. A measured approach to reducing the size of the CLF was also considered appropriate given the uncertain economic environment following the COVID-19 pandemic; the conditions facing banks and the amount of HQLA had changed rapidly over 2020. Accordingly, in calculating the size of the CLF for 2021, APRA assumed CLF banks' surplus ESA balances would be around the (significantly lower) levels of previous years when calculating the size of the CLF for 2021.

The CLF fee has also recently been increased

For a commitment under the CLF, the CLF banks must pay a monthly fee to the Reserve Bank. This fee is charged on the entire committed amount, regardless of whether or not the LCR bank draws down on the CLF over that period. (In the event of a drawing on the CLF, in addition to the set fee, interest would be charged on the amount drawn.) The Reserve Bank aims to set the level of the CLF fee such that banks face similar financial incentives when holding additional HQLA securities or applying for a higher CLF in order to satisfy their liquidity requirements. From 2015 to 2019, the Reserve Bank charged a CLF fee of 15 basis points per annum on the commitment to each bank. Following the 2019 review of the CLF, the CLF fee was increased in 2 steps, to 17 basis points per annum on 1 January 2020 and to 20 basis points per annum on 1 January 2021. This increase was judged appropriate to provide banks with an incentive to manage their liquidity risk appropriately. The fee increase was implemented in 2 steps to ensure a smooth transition by minimising the effect on market functioning. See Bergmann, Connolly and Muscatello (2019) for further details.

Conclusion

Since 2019, the size of the CLF has been reduced substantially because of the increased availability of HQLA and improvements in funding and liquidity conditions for banks. The increased issuance of AGS and semis in order to fund the fiscal responses to the COVID-19 pandemic has meant that CLF banks are able to hold a larger amount of AGS and semis – both in terms of value and the share of issuance – without unduly affecting market functioning. The Reserve Bank has assessed that CLF banks can reasonably hold 30 per cent of the stock of HQLA securities outstanding by the end of 2021. Given this, and APRA's assessment of both the liquidity requirements of CLF banks and their funding and liquidity conditions, the CLF was reduced to $139 billion in April 2021, down from $243 billion in 2019. This reduction was made in measured steps over 2020 and 2021, given the rapidly changing and uncertain environment and to allow banks time to adjust as required. The CLF fee has also been increased since 2019, following a review by the Reserve Bank, to provide banks with an incentive to manage their liquidity risk appropriately. The fee was increased in increments – from 15 basis points in 2019 to 17 basis points in 2020 and to 20 basis points in 2021 – to ensure a smooth transition. ✠

Footnotes

[*] The authors are from Domestic Markets Department.

[1] See BCBS (2013); for more information about the introduction of the CLF, see Debelle (2011)

[2] See APRA (2018)

[3] See APRA (2020)

[4] A portion of the balances held by financial institutions in their ESAs at the Reserve Bank arise from 'open repos' (see footnote 6). The remainder of ESA balances are referred to as surplus ESA balances.

[5] From 31 March 2020, if banks held sufficient available and eligible collateral, APRA also allowed banks to treat available, undrawn Term Funding Facility (TFF) allowances as liquid assets to meet LCR requirements. These allowances, and the ability to count them as liquid assets, are scheduled to expire on 30 June 2021.

[6] Some banks have technically drawn on the CLF, since any usage of the Reserve Bank's standing facilities by a CLF bank is considered to be a drawing on their CLF. In particular, some banks maintain 'open repos' (repurchase agreements contracted without a maturity date) with the Reserve Bank to support the smooth functioning of the payments system. The funds obtained via these open repos are held in the banks' ESAs for use in meeting their payment obligations after normal banking hours, such as from transactions through the New Payments Platform.

These open repos have averaged around $25 billion over the past 6 years, and account for virtually all of the usage of the CLF over this period. The remaining usage of the CLF has been for small transactions used to test banks' systems and access.

[7] See Bergmann, Connolly and Muscatello (2019).

[8] See RBA (2020).

[9] In the early stages of the pandemic, the additional provision of liquidity via the Reserve Bank's daily open market operations also contributed to the rise in ESA balances, though this was a temporary boost which has since been reversed.

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