

4. Developments in the Financial System Architecture

The G20 and the Financial Stability Board (FSB) have continued to work in recent months on key aspects of the four core financial regulation reform areas: building resilient financial institutions; addressing ‘too big to fail’; responding to shadow banking risks; and making derivatives markets safer. Substantial progress has been made in advancing reforms across these four areas ahead of the G20 Leaders’ Summit in Brisbane in November. Challenging areas remain, however, particularly on aspects of ‘too big to fail’ and derivatives markets reform. With Australia as G20 Chair for 2014, the Reserve Bank, along with the Australian Treasury, has been contributing to these efforts in recent G20 and FSB meetings, including the meetings held in Cairns in September. Progress has also been made in other reform areas, including financial benchmarks.

Domestically, the Financial System Inquiry released its *Interim Report* in July. The *Interim Report* raised a range of policy issues across many aspects of the financial system and regulation, though overall it gave a positive assessment of the current financial regulatory framework. Following on from its initial comprehensive submission, the Bank made a second submission to the Inquiry, covering areas related to financial stability and the responsibilities of the Bank, particularly for the payments system. Agencies on the Council of Financial Regulators (CFR) continued to progress domestic reforms. These include proposed new standards by the Australian Prudential Regulation Authority (APRA) on the supervision of financial conglomerates, and a government consultation paper, released by the Treasury, on central clearing of interest rate derivatives denominated in Australian dollars.

International Regulatory Developments and Australia

Building resilient financial institutions

As discussed in previous *Reviews*, much of the policy development work in this reform area (namely the Basel III capital and liquidity reforms) has been completed, and banks globally and in Australia continue to move towards meeting the new requirements. Nonetheless, the Basel Committee on Banking Supervision (BCBS) is working on several outstanding elements of its reforms in this area and will, by the Leaders’ Summit in November:

- finalise the Net Stable Funding Ratio (NSFR), following a consultation earlier in the year. The NSFR is a long-term liquidity requirement which aims to make banks’ funding structures more resilient.
- set out its plan to address excessive variability in banks’ risk-weighted asset (RWA) calculations, to improve consistency and comparability in bank capital ratios. The BCBS has been considering measures such as improved disclosure and narrowing the modelling choices available for banks to calculate RWAs.

In addition to Basel III and related work, the BCBS has over the past six months proposed or finalised measures to enhance aspects of the broader Basel framework for bank supervision and risk management.

- In April, the BCBS published its finalised framework for measuring and controlling banks’ large exposures to a single counterparty. Taking effect from 2019, this framework limits a bank’s

total exposures to a single counterparty to 25 per cent of that bank's Tier 1 capital. A tighter limit of 15 per cent of Tier 1 capital applies to exposures between global systemically important banks (G-SIBs), to reduce the risk of contagion between them.

- In June, the BCBS released its guidelines for dealing with weak banks as well as updated principles for effective supervisory colleges. It also released proposals to change Basel Pillar 3 disclosure requirements.
 - The guidelines for dealing with weak banks emphasise the need for: an effective supervisory framework; supervisors who can detect problems early and act quickly; detailed preparation, including resolution techniques and public disclosure strategies that minimise contagion; and close collaboration with supervisors in other jurisdictions. The consultation ended in mid September.
 - Supervisory colleges are international groupings of supervisors of the parent company and key branches or subsidiaries of global banking groups such as G-SIBs. The key changes to the principles include greater emphasis on: collaboration and information-sharing among college members; consistent feedback from the home and host supervisors to the institution; and the relationship between a G-SIB's college and its crisis management group.
 - Pillar 3 measures aim to enhance market discipline on banks, to complement Basel minimum capital requirements (Pillar 1) and the supervisory review process (Pillar 2). The proposed revisions to the Pillar 3 disclosure regime aim to enhance comparability across banks, with a particular focus on ensuring transparency of the internal models used by banks to calculate minimum capital requirements. The consultation ends in October.

In September, APRA outlined its proposed implementation of BCBS disclosure requirements in several areas. The proposals are based on the relevant Basel framework but with modifications for Australian circumstances.

- In line with the BCBS' timetable, it is proposed that a disclosure requirement for the Basel III leverage ratio commences from January 2015 for the five Australian banks using the internal ratings-based approach to credit risk. These banks are already reporting their leverage ratios to APRA as part of the BCBS' monitoring process.
- It is proposed that authorised deposit-taking institutions (ADIs) subject to the Liquidity Coverage Ratio (LCR) meet LCR disclosure requirements from January 2015, when the LCR becomes effective in Australia. The LCR, which is the BCBS' short-term liquidity requirement, will apply to the larger, more complex ADIs.
- From January 2015, it is proposed that the four major Australian banks must disclose 12 indicators used in the annual G-SIB assessment exercise conducted by the BCBS. While not currently identified as G-SIBs, these four banks have been providing data to the BCBS as part of its annual G-SIB assessment exercise, and meet the size threshold for disclosing data under the G-SIB framework.

APRA also proposed minor amendments to the ADI capital adequacy and public disclosure prudential standards, to remedy minor deviations from the Basel framework that were identified during the BCBS' recent review of Australia's compliance with the Basel capital framework.

Systemically important financial institutions (SIFIs)

A continuing high priority for the FSB has been to address the 'too big to fail' issue posed by SIFIs. Among several ongoing elements of this work, attention has recently focused on developing two aspects: the proposal for total loss-absorbing capacity (TLAC), a variant of which was discussed

in the previous *Review*, and a framework for cross-border recognition of resolution actions. TLAC initiatives aim to ensure that G-SIBs have enough loss-absorbing capacity in a stress event, so they can be resolved in an orderly way that minimises the effect on financial stability and avoids using taxpayer funds for recapitalisation. It is envisaged that TLAC requirements could in part be met through issuance of loss-absorbing debt instruments. Private creditors holding this debt would be 'bailed in' (i.e. their debt claim written down or converted into equity) when a G-SIB approaches resolution.

The FSB is leading the work on finalising the TLAC proposal for presentation to the G20 Leaders' Summit in November. A consultation document is planned to be released in time for the Summit, and the proposal will be subject to a quantitative impact assessment before any final measure is agreed. TLAC requirements are intended to apply to G-SIBs only, so they will not directly apply to Australian banks. However, as G20 Chair, the Australian authorities are working with the FSB towards finalising a proposal which takes into account differing financial system characteristics and legal frameworks, and emphasises financial stability objectives. The TLAC proposal was one of several international regulatory developments discussed at recent CFR meetings.

Establishing a framework for the orderly resolution of large, often complex, banks with sizeable operations in multiple jurisdictions is another priority of the G20 and the FSB. The FSB will soon release a draft consultative report with recommendations for contractual and statutory approaches to ensure cross-border recognition of resolution actions, including bail-in of debt issued under foreign law, as well as temporary stays on early termination rights when a firm enters resolution. As part of this, the financial industry is developing a draft protocol that would support the enforceability of temporary stays. At its recent meeting in Cairns, the FSB discussed the need for regulatory measures to promote broad adoption of the protocol.

Work has also continued internationally on other elements of the SIFI framework.

- Strengthening resolution regimes continues to be a key component of the policies to address 'too big to fail', with jurisdictions encouraged by the FSB to implement its *Key Attributes of Effective Resolution Regimes for Financial Institutions (Key Attributes)*. While implementation has focused mainly on banks, the *Key Attributes* also applies to other types of financial entities that could be systemically significant or critical if they fail. To provide further guidance for authorities implementing specific elements of the *Key Attributes*, especially in relation to non-bank financial institutions, the FSB will publish in mid October annexes to the *Key Attributes* on insurance firms, financial market infrastructures, treatment of client assets, and information sharing. In addition, consultation papers will be published on cooperation and information sharing between G-SIB home and host authorities, and on the identification of critical functions in global systemically important insurers (G-SIIs).
- In April, the FSB released a progress report on enhanced supervision, which describes the changes in supervisory practices since the financial crisis and identifies areas where more work is needed. It also released a framework for assessing risk culture, which takes into account feedback received on an earlier consultative document. These two reports are part of the FSB's ongoing efforts to reduce the risks posed by SIFIs through more intense and effective supervision. Consistent with this, the FSB also recently commenced a 'thematic' peer review, in consultation with the BCBS, on supervisory frameworks and approaches applying to SIFIs.
- In July, following industry feedback on earlier proposals and an initial impact assessment, the International Association of Insurance Supervisors released amended proposals for the design and calibration of a 'basic capital requirement' (BCR) for G-SIIs. A final proposal is due to be issued ahead of the November Summit,

with confidential reporting to supervisors to commence in 2015. The BCR will act as the foundation for the higher loss-absorbency requirement that will apply to G-SIFs, which is to be developed in 2015, based on 10 high-level principles released in September.

- The FSB and the International Organization of Securities Commissions (IOSCO) are continuing their work on developing methodologies for identifying non-bank non-insurer global SIFs. Following industry feedback from a consultation earlier in the year, a second consultation document is planned for release around the end of the year.

Domestically, the CFR continues to work on examining Australia's resolution and crisis management arrangements. At its March 2014 meeting, the CFR adopted a formal crisis management training framework, which incorporates regular training exercises and testing of the CFR agencies' ability to respond and coordinate actions in a crisis situation. The first exercise under the new framework was a workshop in July to review and familiarise CFR agency staff with the detailed arrangements developed for responding to distress in a locally incorporated ADI. Crisis management arrangements encompassing the New Zealand operations of Australian banks are an ongoing focus of the work under the Trans-Tasman Banking Council, which met in July.

Shadow banking

The FSB and other standard-setting bodies continue to work on addressing the risks posed by shadow banking entities and activities such as money market funds (MMFs), finance companies and securities lending. As noted in the previous *Review*, many of the recommendations to reform the oversight and regulation of shadow banking have already been released by the FSB, the BCBS and IOSCO, with the focus now on implementation. Steps have been taken recently to monitor implementation, including through several peer reviews.

- The FSB has conducted an information-sharing exercise as part of its high-level framework for shadow banking entities released in 2013. The results of this process will inform an FSB peer review of implementation in 2015. The Bank provided information on Australia's relatively small shadow banking sector. (For a discussion of developments in Australia's shadow banking sector, see the chapter 'The Australian Financial System'.)
- IOSCO recently launched a peer review on the implementation of its 2012 recommendations relating to MMFs. Separately, in the United States, which has the largest MMF market, the Securities and Exchange Commission agreed in July to implement significant MMF reforms, in particular the requirement of a 'floating net asset value' structure for institutional prime MMFs. These reforms help to address the risks to US financial stability potentially arising from MMF investor runs. Requirements for enhanced diversification, disclosure and stress testing have also been strengthened.
- IOSCO has also initiated a peer review on the adoption of its recommendations, also released in 2012, for aligning incentives in securitisation, including risk retention requirements. The problems associated with complex securitisation products with misaligned incentives for issuers were highlighted internationally during the crisis. In a related development, a new BCBS-IOSCO taskforce, co-chaired by the Australian Securities and Investments Commission (ASIC), is examining global securitisation markets, with the aims of identifying obstacles to the development of sustainable securitisation and helping to develop simple and transparent securitisation structures.
- Domestically, in April, APRA proposed changes to its prudential framework for securitisation. The proposed framework is based on simple, low-risk structures that make it straightforward for ADIs to use securitisation as a funding tool and for capital relief. This, in turn, should help reduce industry complexity and improve ADI risk allocation and management.

Policy development work on shadow banking is continuing in several areas.

- In September, the FSB progressed elements of its framework to reduce risks arising from securities financing transactions (such as repurchase agreements), a key source of leverage for the shadow banking sector. These elements comprise: a revised regulatory framework on haircuts for non-centrally cleared securities financing transactions; and consultative proposals to be issued on numerical haircut floors that would apply to non-bank to non-bank transactions. The FSB is also developing standards and processes for global data collection and aggregation for securities financing transactions, which will be released for consultation before the Leaders' Summit.

Related to this, at its September meeting the FSB also discussed a work plan to examine possible financial stability issues related to collateral re-use (so-called re-hypothecation) and potential harmonisation of regulatory approaches in this area.

- The BCBS is continuing its work on addressing the risks from banks' interactions with shadow banks. The BCBS' finalised framework for large exposures, discussed above, also applies to counterparties that are shadow banks.

The G20 and the FSB remain engaged on the potential for risk to flow to shadow banking, given the tightening of bank regulation. In this respect, the FSB's annual *Global Shadow Banking Monitoring Report* (next due for release in November) assists in monitoring developments, as do review processes in individual jurisdictions such as Australia, where the Bank provides an annual update on Australia's shadow banking sector to the CFR. Review and monitoring efforts are also occurring on a regional basis, with FSB Regional Consultative Groups for Asia and the Americas releasing reports in August on shadow banking in their regions. The Bank, along with the Treasury, contributed to the report for Asia.

Over-the-counter (OTC) derivatives markets and financial market infrastructures

In April, the FSB released its latest progress report on the implementation of OTC derivatives market reforms agreed by the G20. The FSB noted that there had been continued progress in implementing these reforms. Most jurisdictions have made necessary changes to legislative frameworks and are developing or bringing into force detailed rules where required. Market participants' use of centralised infrastructure continues to increase, and jurisdictions (including, since April, the European Union) have further encouraged this by proposing or implementing central clearing requirements. Within this overall picture of progress, results are still uneven across particular reforms. Broadly, there are clear signs of progress in the implementation of trade reporting, capital requirements and central clearing. However, implementation of reforms to promote trading on exchanges or electronic trading platforms is taking longer.

More generally, the cross-border issues arising from these reforms continue to require attention. As discussed in the previous *Review*, a G20 goal is to allow OTC derivatives market regulators to defer to each other when it is justified by the quality of their regulatory and enforcement regimes. While some progress has been made in this area, further work on equivalence and substituted compliance assessments is needed. To encourage progress, in September the FSB published a report on jurisdictions' current processes for deferring in this way. As well as publicising cases where further progress could be made, this report helps jurisdictions understand what their counterparts require to assess a regime as equivalent. Also in September, the OTC Derivatives Regulators Group, which brings together relevant regulators from several jurisdictions, including Australia, issued a further report on addressing cross-border implementation issues. For the Leaders' Summit, the group will also report on how it intends to resolve

remaining issues together with a timetable for implementing the solutions.

In Australia, authorities continue to implement OTC derivatives market reforms, with necessary consultation between agencies often conducted through the CFR.

- In their third report on the Australian OTC derivatives market, published in April 2014, the regulators (APRA, ASIC and the Bank) recommended introducing mandatory clearing requirements for Australian dollar-denominated interest rate derivatives between internationally active dealers. This recommendation in part reflects that the Australian dollar interest rate derivatives market is the largest and most systemically important component of the OTC derivatives market in Australia and that it could also be subject to mandatory clearing requirements in other jurisdictions in the future. The government has since consulted on proposals consistent with these recommendations. This consultation builds on earlier proposals by the government, based on regulators' recommendations in 2013, to impose a similar mandatory clearing requirement on interest rate derivatives denominated in US dollars, euro, British pounds and Japanese yen. As discussed in the chapter 'The Australian Financial System', even without a mandatory clearing requirement in Australia, most new interdealer interest rate derivatives trades are already being centrally cleared. This reflects that pricing and liquidity are more favourable where trades are centrally cleared, in part because mandates are already in place in some other jurisdictions.
- Another focus of the April 2014 report was whether a mandatory clearing requirement should be extended to smaller ('non-dealer') participants in the Australian OTC derivatives market. In their report, the regulators noted that even though requiring central clearing by non-dealers might help reduce systemic risk, the benefits may not outweigh the costs. Accordingly, they recommended that mandatory

central clearing of OTC derivatives should not be extended to non-dealers at present, but committed to keep the matter under review.

- Requirements to report OTC derivatives transactions continue to be phased in. As of April, all financial entities with greater than \$50 billion notional principal of OTC derivatives outstanding have been required to report transactions to trade repositories. Smaller financial entities will start reporting in 2015. In addition, in September DTCC Data Repository (Singapore) (DDRS) became the first trade repository to be licensed to operate in Australia. Under the licensing regime, DDRS is overseen by ASIC and subject to stringent standards based on the *Principles for Financial Market Infrastructures* (PFMIs). However, ASIC is also placing a high degree of reliance on the Monetary Authority of Singapore, which is DDRS' home supervisor.

Standard-setting bodies have also recently finalised elements of international policy work relevant to OTC derivatives markets.

- In April, the BCBS issued a final standard for capital requirements for bank exposures to central counterparties (CCPs). This framework supports broader policy efforts advanced by the G20 and the FSB, particularly those noted earlier promoting central clearing of standardised OTC derivatives contracts. The final standard includes, among other requirements, a single approach for calculating capital requirements for a bank's exposure arising from its contributions to the mutualised default fund of a qualifying CCP and an explicit cap on the capital charges applicable to those exposures. The standard will take effect from 2017 (interim requirements released earlier will continue to apply until that time).
- In September, IOSCO launched a consultation on risk mitigation standards for non-centrally cleared OTC derivatives. While a key plank of G20 reforms has been to encourage central clearing of standardised OTC derivatives, a substantial proportion of OTC derivatives are not standardised and hence not suitable for central

clearing. The proposed standards complement the BCBS-IOSCO margin requirements framework for non-centrally cleared derivatives released in September 2013. The proposed standards aim to promote legal certainty and facilitate timely resolution of disputes between counterparties by, among other things, establishing requirements around the timely confirmation of trades, as well as the process of valuing and reconciling trades between two counterparties. The consultation closes in mid October.

- Following an earlier consultation, the FSB released a report in September on how information from trade repositories could be aggregated and shared. Such data can be used by authorities to monitor global trends in OTC derivatives markets, and in particular the risks arising from these markets.

In May 2014, a taskforce established by IOSCO and the Committee on Payment and Settlement Systems – since renamed the Committee on Payments and Market Infrastructures – released a report on jurisdictions progress in implementing the PFMI. The PFMI were issued in 2012 by the two standard-setting bodies to update, harmonise and strengthen the pre-existing standards for financial market infrastructures, particularly in light of their increasing use in the context of the reforms noted above. The taskforce, on which the Bank is represented, was established to help ensure the consistent implementation of the PFMI across its member jurisdictions. In its progress report, the taskforce assessed further steps taken by 28 jurisdictions to incorporate the PFMI within their respective regulatory frameworks. It concluded that implementation was well advanced for the regulatory frameworks for CCPs, trade repositories and payment systems. Several jurisdictions (including Australia) had completed their implementation measures. The taskforce has now commenced a more detailed assessment of the implementation of the PFMI, focusing initially on CCPs and trade repositories in the three largest jurisdictions (the United States, the European Union and Japan). The taskforce aims

to complete assessments of all three jurisdictions ahead of the G20 Summit in November.

Other developments

International bodies continue to work on regulatory issues beyond the core areas noted above, both to address gaps revealed by the crisis, and as part of ongoing efforts to enhance regulatory frameworks and arrangements.

Work has been ongoing to review and reform financial benchmarks following concerns about their integrity.

- Through an Official Sector Steering Group (OSSG), of which the Bank is a member, the FSB has been examining the setting of interbank and other financial benchmark rates. The OSSG assessed the feasibility and viability of existing and alternative benchmark rates, taking into consideration input from a related group of private sector participants. Based on this work, the FSB released a report in July which sets out proposals and timelines for the reform and strengthening of existing major interest rate benchmarks (LIBOR, EURIBOR and TIBOR) and for additional work to develop and introduce alternative risk-free benchmarks. The Bank also co-chairs a group looking at foreign exchange benchmarks: the FSB will release a report with recommendations by the end of September.
- As part of the FSB's work, an IOSCO group (co-chaired by ASIC) has been reviewing the implementation of IOSCO's *Principles for Financial Benchmarks* by the administrators of the three major interest rate benchmarks. In July, IOSCO released its review report which found that all three administrators had made significant progress in implementing the majority of IOSCO's principles, which cover overall oversight, governance, transparency and accountability. This has improved the quality and integrity of the benchmarks. IOSCO did note, however, that further work was needed in the areas of benchmark design, data sufficiency and transparency of benchmark determinations.

Over the past six months, efforts have continued to reduce the mechanistic reliance on credit rating agency (CRA) ratings.

- In May, the FSB released a peer review of members' progress in implementing the FSB's *Principles for Reducing Reliance on CRA Ratings*. While some progress has been made, challenges remain. In particular, identifying alternative standards for assessing creditworthiness has proven difficult, as has the removal of ratings from international risk-based prudential frameworks for banks and insurers. The report recommends that national authorities continue to work with market participants to strengthen internal credit assessment processes and develop alternative measures of creditworthiness, so that CRA ratings are only one input into credit assessments.
- In June, IOSCO released for consultation *Good Practices on Reducing Reliance on CRAs in Asset Management*. While acknowledging that external credit ratings are useful inputs into internal credit assessments, the report outlines practices which encourage internal credit assessments that are not solely based on external credit ratings. These practices include: internally assessing the credit quality of financial instruments; and understanding the methodologies used to obtain the external credit rating. Regulators could also encourage investment managers to disclose how external credit ratings are used in internal credit assessments.

In October, the FSB, in collaboration with the International Monetary Fund and the Organisation for Economic Co-operation and Development, is expected to report on the cross-border consistency and global financial stability implications of planned or implemented domestic structural banking reforms such as the 'ring-fencing' proposals by some jurisdictions. Many of these measures seek to address the domestic 'too big to fail' problem, but can also affect financial institutions and markets in other countries.

At its September meeting, the FSB agreed that it will prepare from 2015 a consolidated annual report

to the G20 on the implementation of the reforms and their effects. This will help improve accessibility and comparability of information and thereby promote timely and consistent implementation of agreed reforms. The FSB and international standard-setting bodies will also publish information in 2015 summarising their processes for policy development and implementation reviews. This should enhance transparency and improve the public understanding of the work of these bodies, and how they go about executing their mandates.

In recent months, the FSB has been reviewing the structure of its representation, and proposals are being developed that, in part, respond to the increasingly important role of emerging markets in the global economy and the financial system. Australian authorities, including the Bank, provided input to the review, and the FSB's proposed approach was discussed at both the FSB and G20 meetings in September; a report is due to the Leaders' Summit.

Other Domestic Regulatory Developments

Financial System Inquiry

The *Interim Report* of the Financial System Inquiry – the first comprehensive review of the Australian financial system in 17 years – was released in mid July. A broad range of policy options were put forward, with the efficacy of the consumer disclosure regime and the superannuation system in focus. The *Interim Report* gave broad support for the existing regulatory architecture and it acknowledged the effectiveness of existing coordination arrangements under the CFR. However, it did highlight some areas for improvement, including some potential measures to promote increased coordination among regulators. In addition, the *Interim Report* raised the option of formalising the role of the CFR within statute, as well as expanding its membership and responsibilities. Several options were raised to mitigate systemic risk and address any perceptions that some entities are 'too big to fail', including strengthening resolution and pre-planning arrangements to handle financial

distress, and separating or 'ring-fencing' certain aspects of banks' businesses.

To complement its comprehensive initial submission to the Inquiry, the Bank provided a targeted *Supplementary Submission*, focusing on the issues raised in the *Interim Report* that directly relate to financial stability and the responsibilities of the Bank. It gave broad support for a number of the themes raised in the *Interim Report*, including the call for strong, independent and accountable regulators and the consideration of impediments to the provision of small business finance. The *Supplementary Submission* also emphasised the following points.

- Reforms over the past decade or so have been effective in improving competition and efficiency in payment systems. The Bank's current approach to payment system regulation, as overseen by the Payments System Board, remains appropriate. However, there may be scope to clarify how purchased payment facilities are regulated.
- The CFR has worked well and cooperatively under its existing informal arrangements and charter. If there is appetite to formalise arrangements and/or increase the responsibility of the CFR, care should be taken to ensure that the existing powers and independence of each member agency are not eroded, and that the emphasis on cooperation remains.
- Any proposed new measures to enhance system stability should account for the work already underway – globally and domestically – to improve the resilience of the financial system. This is a challenging area for policy development; hence, care should be taken in implementing new policies and consideration given to how these changes may interact with pre-existing policies.
- Superannuation assets should be managed in the best interests of members. Measures to lower costs and fees, optimise liquidity management and limit leverage should be considered.
- The supply of mortgage finance in Australia is ample. Therefore, any proposed policies that

could further increase that supply should be subject to rigorous analysis of their costs, benefits to consumers and risks to financial stability.

The Inquiry will provide a final report to the Treasurer by November.

Other developments

Following feedback on earlier proposals, APRA released its planned supervisory framework for financial conglomerate ('Level 3') groups in August. This framework draws on the Joint Forum's revised *Principles for the Supervision of Financial Conglomerates* released in September 2012, and will provide APRA with a better understanding of the risks to which APRA-regulated institutions within Level 3 groups are exposed, particularly from non-APRA-regulated activities. APRA responded to issues raised by industry on all four components of the framework: group governance, risk exposures, risk management and capital adequacy. APRA listed eight conglomerate groups which will become subject to the Level 3 framework when it is implemented. However, these groups, which control around 80 per cent of the assets of all APRA-regulated institutions, will not need additional capital to meet the planned new requirements. The framework will be finalised by APRA after the government responds to the recommendations of the Financial System Inquiry.

As discussed in 'The Australian Financial System' chapter, APRA recently released for consultation a draft *Prudential Practice Guide – Residential Mortgage Lending*. Since residential mortgages make up a significant proportion of Australian banks' credit exposures, monitoring housing lending standards is an important part of APRA's supervisory role. In its draft document, APRA has provided guidance on risk management practices for housing lending, including: addressing the risks associated with residential mortgage lending in the bank's risk management framework; considering loan origination channels and their associated risks; ensuring portfolio limits for riskier loans are observed; valuing underlying collateral in an appropriate way; and undertaking robust stress testing. ✎

