

The Committed Liquidity Facility: 2015–2022

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Abstract

The Reserve Bank's Committed Liquidity Facility (CLF) was used from 2015–2022 to enhance the resilience of the banking system to times of liquidity stress. Banks must hold high-quality liquid assets (HQLA), including government securities, as a buffer against liquidity stress. Historically, the low level of government debt in Australia limited the amount that banks could reasonably hold, and so the CLF was introduced in 2015 as an alternative. Over time, however, the amount of government debt on issue and system liquidity increased significantly due to fiscal and monetary policy measures implemented to support the Australian economy during the COVID-19 pandemic. In response to this significant increase in HQLA, the size of the CLF was gradually reduced so that it was no longer in use at the beginning of 2023. This article provides an overview of the CLF and discusses its introduction and why it is no longer in use.

Introduction

The Reserve Bank provided the Committed Liquidity Facility (CLF) from 2015–2022 as part of Australia's implementation of the Basel III liquidity standard to strengthen the resilience of the banking system to periods of liquidity stress. In particular, the liquidity coverage ratio (LCR) under the Basel standard 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

Basel III, jurisdictions with a clear shortage of domestic-currency HQLA can use other approaches to enable financial institutions to satisfy the LCR – including the central bank offering a CLF.

The Reserve Bank provided the CLF to banks for an annual fee based on the size of the Reserve Bank's commitment through the CLF to the relevant bank, regardless of whether the bank drew down on the facility or not. The Australian Prudential Regulation Authority (APRA) administers the LCR in Australia

and from 2015–2022 made use of the CLF to help banks to meet their requirements.

This article provides an overview of the CLF, explains how it worked and discusses why it is no longer in use.

Overview of the CLF

HQLA are assets that banks can use to cover their short-term liquidity needs. For securities to be considered HQLA, they need to be low risk and be traded in an active and sizeable market. The 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).^[1] While AGS and semis are actively traded in financial markets, there has historically been relatively little trading in other key types of Australian dollar securities, such as asset-backed securities and corporate bonds (Graph 1).^[2] The only other forms of HQLA available in Australian dollars are liabilities of the Reserve Bank – namely, banknotes and Exchange Settlement (ES) balances.

At the time the CLF was announced in 2011, the stock of AGS and semis had historically been insufficient for banks to meet their liquidity needs. At the time the CLF became operational in 2015, government debt in Australia was around 40 per cent of GDP, which was low relative to the

HQLA needed to meet banks’ LCR requirement (Graph 2). In the absence of something like a CLF, banks would collectively 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 HQLA securities, it would have reduced the liquidity of those securities, undermining the purpose of holding them as HQLA.

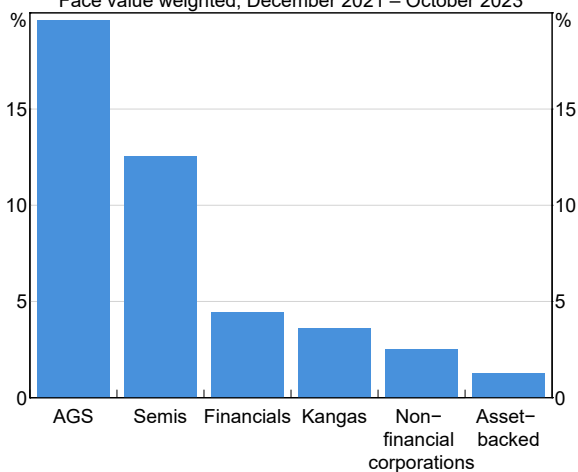
To avoid the situation of banks holding unduly high shares of the AGS and semis markets, APRA permitted certain banks subject to the LCR requirement to make use of the CLF provided by the Reserve Bank. Before doing so, banks had to apply to APRA for approval to access the CLF. They also had to demonstrate that every reasonable effort had been made to manage liquidity risk independently rather than relying on the CLF.

The CLF involved the Reserve Bank making a commitment to a bank to provide liquidity to cover any shortfall between that bank’s ‘reasonable’ holdings of HQLA (i.e. the amount that could be held without impairing market functioning or liquidity) and the LCR requirement. The CLF bank could then access this committed amount of liquidity if it was required during a period of liquidity stress. High-quality Australian dollar securities that met Reserve Bank criteria were required as collateral to access the CLF, including self-securitised residential mortgage-backed securities, securities issued by authorised deposit-

Graph 1

Monthly Turnover Ratio for AUD Bonds*

Face value weighted; December 2021 – October 2023

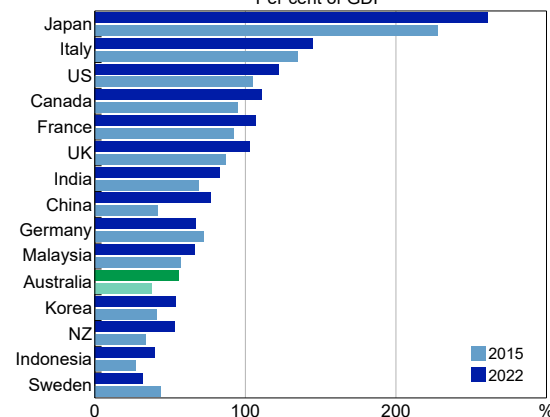


* Excludes trades with the RBA. Sources: ASX Information Services; RBA.

Graph 2

General Government Gross Debt

Per cent of GDP



Source: IMF.

taking institutions and supnationals, and asset-backed securities.

To access the CLF (i.e. to draw on CLF funds), a CLF bank had to make a formal request to the Reserve Bank, including providing an attestation from the chief executive-officer of the bank that it had positive net worth. The bank also needed to have positive net worth in the opinion of the Reserve Bank.

Jurisdictions with low levels of government debt have used a range of approaches under Basel III's alternative liquidity approaches to address a shortage of domestic currency HQLA. Australia is one of a small number of countries that put in place a CLF. Some other jurisdictions have allowed financial institutions to hold HQLA in foreign currencies to cover their liquidity needs in domestic currency. However, the main downside of this approach is that it relies on foreign exchange markets to be functioning smoothly in a time of stress and increases the foreign currency exposures in the banking system. Another approach has been to classify a broader range of domestic currency securities as HQLA. This approach was not taken in Australia due to Australian dollar securities other than AGS and semis being considered insufficiently liquid.

Design of the CLF

The total size of the CLF was the difference between the aggregate liquidity requirements of CLF banks and the aggregate amount of HQLA securities that the Reserve Bank assessed the CLF banks could 'reasonably' hold to fulfil these requirements without impairing bond market liquidity. The liquidity requirements of individual CLF banks were assessed by APRA. The requirements included 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 took account of the banks' projected holdings of other HQLA (i.e. banknotes, surplus ES balances and undrawn Term Funding Facility (TFF) allowances when they were available). Banks could access their committed amount of liquidity if it was required in a period of liquidity

stress, subject to the bank having satisfied several conditions.^[3]

From 2015–2019, the CLF operated as follows. APRA adjusted the size of the CLF at the beginning of each calendar year based on estimates of requirements in the year ahead (Table 1). Then, in mid-June, the Reserve Bank would publish its estimate of reasonable holdings of AGS and semis for December of the following year. APRA then asked CLF banks to produce a forecast of their Australian dollar-denominated NCOs and HQLA holdings, and their requested CLF amounts, for the following calendar year. From 2020, however, large changes in the stock of government bonds outstanding and changes in bank funding and liquidity led APRA to gradually adjust the size of the CLF lower so that it was no longer in use at the beginning of 2023, as discussed below.

Factors leading to the reduction in size of the CLF

Increase in supply of government debt

The reduction in the size of the CLF reflects, in part, the sharp increase in the stock of AGS and semis outstanding because of issuance to finance governments' support measures that were provided in response to the COVID-19 pandemic (Graph 3). In addition, the stock of government securities was projected to increase further over coming years. The increase in the stock of AGS and semis outstanding 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. As a result, the size of the CLF required to cover the shortfall between a bank's reasonable holdings of HQLA and its LCR requirements declined gradually each year.

From 2015–2019, the Reserve Bank assessed that CLF banks could reasonably hold 25 per cent of the stock of AGS and semis outstanding. This was informed by the fact that a large proportion of HQLA securities were owned by 'buy and hold' investors, who were generally price inelastic, and not making their securities available to borrow in repo markets. The 25 per cent reasonable holding assessment was subsequently revised in 2019 following a review of the CLF, with the Reserve

Table 1: Reasonable Holdings of HQLA Securities and the CLF

A\$ billion

Date	Projection of HQLA securities outstanding ^(a)	Locally incorporated LCR banks		
		Reasonable holdings of HQLA securities ^(a)	LCR requirements ^(b)	CLF amount ^(b)
31 Dec 2015	700	175	449	274
31 Dec 2016	780	195	441	246
31 Dec 2017	880	220	437	217
31 Dec 2018	905	226	474	248
31 Dec 2019	898	225	468	243
31 Dec 2020 ^(c)	1,340	362	550	188
31 Dec 2021	1,488	446	582	136
31 Dec 2022	1,608	563	<563	0 ^(d)

(a) The Reserve Bank's 'Projection of HQLA securities outstanding' and assessment of 'Reasonable holdings of HQLA securities' for the end of the referenced calendar year.

(b) 'LCR requirements' refers to the aggregate of APRA's assessment of the liquidity required for individual banks to meet their needs for a 30-calendar-day severe stress scenario. It reflects aggregate Australian dollar net cash outflows 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, and taking into account banks' projected holdings of banknotes and ES balances. 'CLF amount' is the difference between the LCR requirements and reasonable holdings of HQLA securities, or zero where reasonable holdings exceed LCR requirements.

(c) The Reserve Bank's projection of HQLA securities outstanding at the end of 2020 and assessment of the amount of these securities that can reasonably be held by locally incorporated LCR banks were updated in November 2020. APRA's assessment of CLF amounts was also updated in late 2020. The initial amounts determined for end-2020 as part of the usual annual CLF process and published in 2019 were as follows: projected HQLA securities outstanding of \$934 billion, reasonable holdings of \$243 billion and CLF amount of \$223 billion.

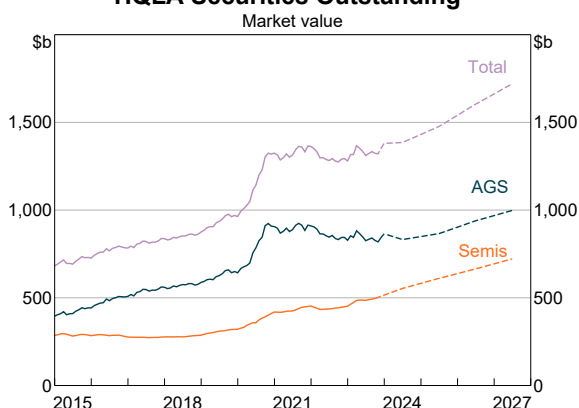
(d) The CLF was reduced to zero on 1 January 2023.

Sources: APRA; RBA.

Bank assessing 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 along with growth in the repo market (Bergmann, Connolly and Muscatello 2019).

This approach was reviewed anew following the sharp increase in the stock of AGS and semis outstanding in 2020, with the Reserve Bank assessing that the increase in the share of AGS and semis that banks could reasonably hold could occur more quickly. It was assessed that the share of the stock of HQLA securities that could be reasonably held by CLF banks could increase to 27 per cent of the stock outstanding by the end of 2020, to 30 per cent by the end of 2021, and 35 per cent by the end of 2022. CLF banks' combined holdings of AGS and semis increased substantially over 2020, although their AGS holdings declined significantly from late 2020 as the banks sold AGS to the Reserve Bank during the bond purchase program (Graph 4). Holdings of semis by CLF banks declined only slightly over 2021 – consistent with the Reserve Bank Bond Purchase Program (BPP) being more

Graph 3**HQLA Securities Outstanding***

* Dash lines are projections from issuing authorities' latest borrowing program updates.

Sources: ABS; AOFM; RBA; State and territory treasury corporations; Treasury.

heavily weighted to AGS than semis. CLF banks' holdings of semis increased over 2022. Overall, CLF banks were able to meet their LCR requirements holding less HQLA securities than the Reserve Bank judged could be reasonably held over 2021 and 2022. In part, this reflected improvements in liquidity conditions for banks associated with the Reserve Bank's policy measures (discussed below). From 1 January 2023, CLF banks have continued to increase their holdings of HQLA securities, largely driven by acquiring more semis. While the share of total outstanding HQLA securities held by CLF banks has returned to around the pre-pandemic level, the share of semis held is considerably higher.

The increase in system liquidity and improved liquidity conditions for banks

The reduction in the size of the CLF was 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 during the pandemic contributed to a significant increase in liquidity in the banking system (Dowling and Printant 2021). Surplus ES balances that banks hold at the Reserve Bank, which are a form of HQLA, increased by more than \$400 billion between March 2020 and the peak in early 2023, due to the monetary policy measures introduced to support the Australian economy (Graph 5).

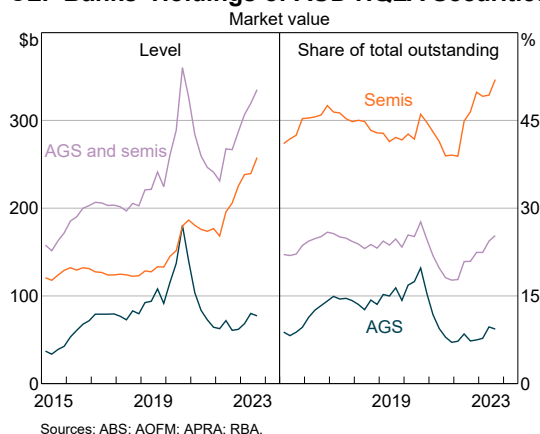
The Reserve Bank's purchases of government bonds as part of the BPP, to aid market functioning and to support the yield target on the three-year Australian

Government bond, contributed around two-thirds of the increase in ES balances. Some of these bonds were purchased directly from CLF banks, as reflected in the decline in their holdings of AGS and semis. When the Reserve Bank buys bonds from a bank, it pays for the bonds by crediting that bank's Exchange Settlement Account (ESA). In this transaction, one type of HQLA is swapped for another, and the level of HQLA held by the bank stays the same. However, when the Reserve Bank buys bonds from a non-bank investor, it pays for the bonds by crediting ES balances to the investor's bank, which creates HQLA for this bank and a deposit for the non-bank investor. Importantly, those ES balances created in this way stay within the banking system, even if their location might vary over time.^[4] The effect on the LCR of the increase in HQLA for this bank is offset, in some part, by an increase in the bank's liquidity needs due to an increase in NCOs arising from the increase in deposits.

Funding provided by the Reserve Bank under the TFF contributed to around one-third of the rise in ES balances. However, in contrast with the purchases of government bonds, the funding provided by the TFF generally increased the level of HQLA held by banks without a corresponding reduction in HQLA securities held by them (as most of the securities pledged as TFF collateral were self-securitised assets) (Black, Jackman and Schwartz 2021). The rise in surplus ES balances, all else being equal, implies less need for the CLF. However, it is important to note that the level of ES balances will depend on (and change with) monetary policy developments. Surplus ES balances declined by around \$120 billion to the end of September 2023, largely driven by the maturity of the first tranche of the TFF, with the remaining balance to mature by mid-2024.

While the stock of available HQLA increased significantly from early 2020, the liquidity needs of banks also increased due to a sharp rise in bank deposits. This increase in bank deposits (in particular, strong growth in at-call deposits) was associated with an increase in NCOs, which in turn increased the amount of HQLA that CLF banks were required to hold under the LCR (Graph 6). However, the increase in available HQLA was larger than the

Graph 4
CLF Banks' Holdings of AUD HQLA Securities



increase in NCOs. Consequently, the size of the CLF was able to be gradually reduced so that it was no longer in use at the beginning of 2023. During the same period, banks’ aggregate LCR remained well above the minimum regulatory requirement of 100 per cent.

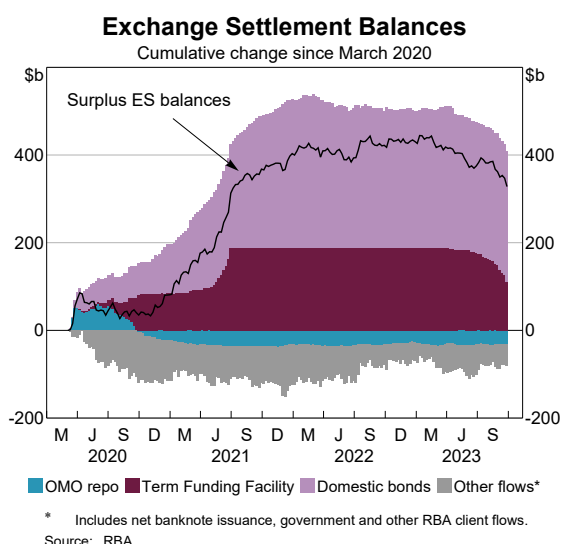
Gradual reduction of the CLF

The aggregate CLF amount was equal to the projected LCR requirements of the CLF banks less the Reserve Bank’s assessment of the banks’ reasonable holdings of HQLA. From 2015–2019, APRA reduced the aggregate size of the CLF from \$274 billion in 2015 to \$243 billion in 2019 as projected liquidity requirements over this period increased by less than the volume of HQLA

securities the banks could reasonably hold (Graph 7).

Given the changes in HQLA and NCOs from 2020, APRA allowed CLF banks to apply for interim adjustments to CLF allowances to help them manage their LCR (APRA 2021b). Accordingly, the aggregate CLF amount was further reduced from \$223 billion in January 2020 to \$33 billion in December 2022. This reduction was made in a measured and staggered way to minimise the risk of any financial market disruptions associated with reduced demand by banks for assets previously used to collateralise CLF allowances, particularly in light of the uncertain economic environment, and the conditions facing banks, including the amount of HQLA they needed. The CLF was no longer in use at the beginning of 2023.

Graph 5



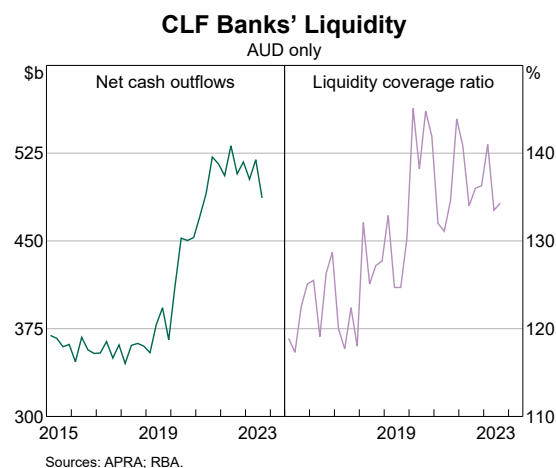
Drawing on the CLF

During the time that the CLF was in use, no bank needed to draw on the CLF for the purposes of managing liquidity in a period of financial stress. However, some banks did draw on the CLF over this time, since any use of the Reserve Bank’s standing facilities by a CLF bank was considered to be a drawing on their CLF.^[5]

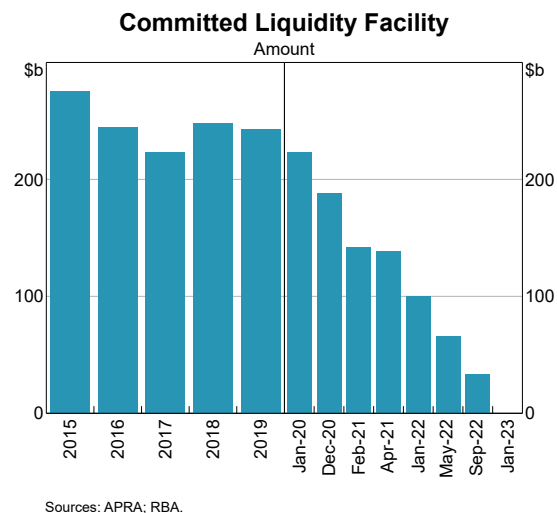
The CLF fee

From 2015–2022, banks paid a monthly fee to the Reserve Bank for their CLF allotment. This fee was charged on the entire committed amount,

Graph 6



Graph 7



regardless of whether or not a bank drew down on the CLF.^[6] The Reserve Bank set the level of the CLF fee such that banks faced similar financial incentives to meet their liquidity requirements through the CLF or by holding HQLA securities (if there were enough available).

A starting point for assessing the appropriate CLF fee was to compare the yields on the CLF collateral and the HQLA securities held by the CLF banks. This difference included the compensation required by banks to account for the higher credit risk associated with holding CLF collateral rather than HQLA securities, but it was only the additional liquidity risk associated with holding CLF collateral that should be reflected in the CLF fee. In practice, adjusting the spread between CLF collateral and HQLA securities to remove the credit risk component was not straightforward. Consequently, there was uncertainty about the exact level of the fee that would make banks indifferent to holding more HQLA or applying for a larger CLF amount. If the CLF fee was set too high, this could have triggered a disruptive shift away from using the facility and distort the markets that use HQLA. This also could have had implications for the implementation of monetary policy, since the market that underpins the cash rate involves the trading of ES balances, which are also HQLA.

During the first five years of the CLF, the CLF banks (in aggregate) consistently overestimated their liquidity requirements. This resulted in the CLF banks being granted larger CLF amounts, which they used to hold larger buffers above the minimum required LCR of 100 per cent. The CLF banks also held fewer HQLA securities than the Reserve Bank had judged could be reasonably held without impairing the market for HQLA securities. Taken together, these two observations suggested that the CLF fee from 2015–2019 of 15 basis points per annum was too low. Indeed, following a review in 2019, the CLF fee was increased to 17 basis points per annum on 1 January 2020 and 20 basis points per annum on 1 January 2021, which remained in place to the end of 2022. This two-step increase was considered appropriate to amend the incentives

around liquidity management options, without generating unwarranted distortions in the markets that use HQLA. It was implemented in two steps to ensure a smooth transition by minimising the effect on market functioning (Bergmann *et al* 2019; Kent 2019).

Conclusion

The Reserve Bank provided the CLF from 2015–2022 as part of Australia’s implementation of the Basel III liquidity standard. The CLF met its objectives by improving the banking system’s resilience to potential liquidity stress during a period where the stock of HQLA alone was insufficient for banks to meet the LCR requirement. In 2019, a review by the Reserve Bank led to some modest and gradual adjustments to arrangements around the CLF, in a way that reduced the need of the CLF banks to make use of the CLF, while also increasing their cost of doing so. Since early 2020, the increased issuance of AGS and semis, combined with a large increase in system liquidity and associated improvements in funding and liquidity conditions for banks, led to a managed reduction in the size of the CLF needed for banks to meet the LCR requirement. Its use was fully phased out in January 2023. Overall, these changes helped to ensure that banks continued to have suitable options to manage their liquidity risk appropriately.

Banks have managed the transition away from the CLF smoothly and their aggregate LCR remains well above minimum regulatory requirements. With the effects of pandemic-era stimulus still very much reflected in the stock of AGS and semis, and with further change ahead in the Reserve Bank balance sheet, the environment for banks’ liquidity management will continue to evolve. On current projections, the stock of HQLA securities is projected to increase further over coming years, while the volume of ES balances will decline by around \$100 billion by mid-2024 with the maturity of the TFF. Consequently, the banks, APRA and the Reserve Bank will continue to closely review developments in markets for HQLA. ✎

Endnotes

- [*] The authors are from Domestic Markets Department.
- [1] Debt securities of the Export Finance and Insurance Corporation and Housing Australia (previously National Housing Finance and Investment Corporation) are also considered HQLA for the purposes of the LCR requirement in Australia (APRA 2021a).
- [2] The data used to estimate turnover in Graph 1 only include trades settled between counterparties that use separate Austraclear accounts, and so do not represent all trades in these securities. Transactions of Australian dollar securities may be settled through clearing systems other than Austraclear, such as Euroclear or Clearstream. These missing transactions tend to add a downward bias to our turnover estimates.
- [3] The legal documentation for the CLF is published on the Reserve Bank’s website: see RBA (2019a); RBA (2019b).
- [4] ES balances created through the Reserve Bank’s government bond purchases will eventually decline as the bonds mature, with the exact timing and amount depending on how the bond maturities are financed.
- [5] 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 a bank’s ESA for use in meeting its payment obligations after normal banking hours. These open repos account for most of the CLF use over this period. The remaining CLF use was for small transactions used to test a bank’s systems and access.
- [6] In the event of a drawing on the CLF, in addition to the set fee, interest would be charged on the amount drawn.

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