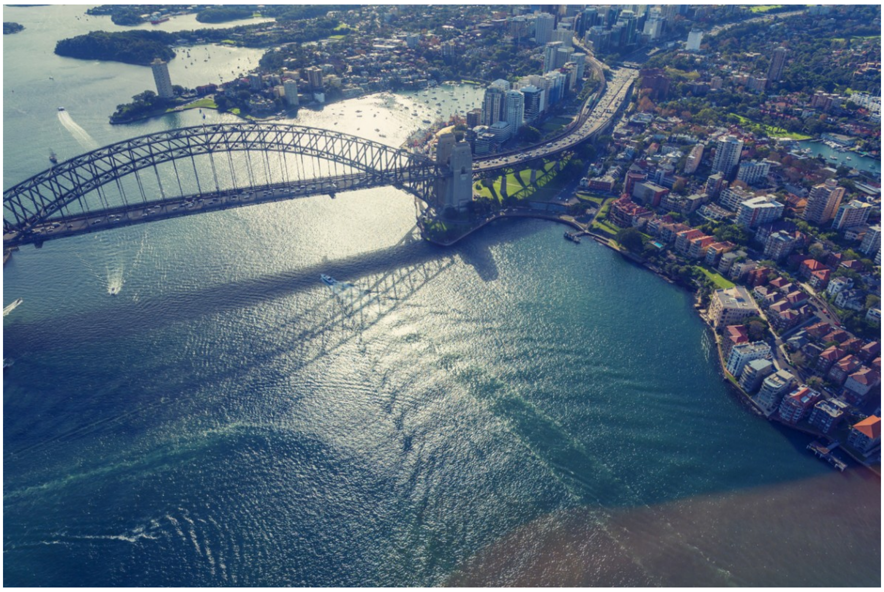
Snap | 19 July 2017

Australian banks told to hold more capital

Australian regulator has increased capital requirements for major banks, which are expected to be met by January 2020



Today, the Australian Prudential Regulation Authority (APRA) announced “unquestionably strong” capital benchmarks for Australian banks. The four major Australian banks need to have CET1 capital ratios of at least 10.5%. According to APRA, this is an average c.100bp above their December 2016 levels.

For authorised deposit-taking institutions (ADIs) that use the internal ratings-based (IRB) approach to credit risk, APRA raises the minimum capital requirements by 150bp to achieve this outcome. For ADIs that use the Standardised Approach the capital requirements are raised by around 50bp.

All ADIs are expected to meet the new capital benchmarks by 1 January 2020. APRA’s proposals to establish unquestionably strong capital ratios follow the December 2014 recommendations of the Financial System Inquiry (FSI) that APRA should set standards ensuring unquestionably strong ADI capital ratios.

Later this year, APRA intends to publish a discussion paper proposing changes to the capital framework to establish capital requirements that underpin unquestionably strong capital ratios.

This paper is likely to include the Basel III changes on credit risk, operational risk and the capital floor. It is also expected to address the Australian ADIs' structural concentration of exposure to residential mortgages.

APRA has already taken measures in the past to address housing market-related risks, including the 30% limitation to new interest only lending introduced in March.

Since July 2016, risk weights on residential mortgages were raised to 25% for banks that use the IRB.

APRA expects to release the final prudential standards in 2019 which are to take effect at the beginning of 2021. However, APRA anticipates the ADIs to already meet the capital benchmarks one year ahead of this date.

> Given the prevailing concerns regarding the Australian housing market imbalances, the additional capital requirements, in our view, are supportive to market confidence in the capital strength of Australian banks.

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