



12 July 2021

TO: ALL AUTHORISED DEPOSIT-TAKING INSTITUTIONS

CONSULTATION ON ZERO AND NEGATIVE INTEREST RATES

The Australian Prudential Regulation Authority (APRA) is today releasing for consultation its draft expectations regarding ADIs' preparedness for zero and negative interest rates.

Background

The Reserve Bank of Australia has stated that a negative cash rate is highly unlikely in Australia. This, however, does not preclude the possibility of a negative cash rate in the future. Irrespective of the level of the cash rate, it is possible that other interest rates determined in the financial markets could fall to zero or below zero at any time.

Accordingly, in December 2020, APRA wrote to all regulated entities regarding their preparedness for zero and negative interest rates and requested entities with material readiness issues to advise the nature of the issues and the timeframes for rectification/mitigation.

Responses from ADIs indicated that they are typically well-placed to deal with zero and negative market interest rates on financial market products such as those typically managed in a treasury system. However, for some ADIs, zero and negative interest rates on other products (e.g. wholesale and retail lending and deposit products) would pose operational challenges. Furthermore, a number of ADIs noted high costs and competing priorities as being constraints for the implementation of permanent solutions.

Risks from zero and negative interest rates

Prudential Standard CPS 220 *Risk Management* (CPS 220) requires an ADI to maintain a risk management framework to manage material risks. As defined in CPS 220, material risks are those that could have a material impact, both financial and non-financial, on the ADI or on the interests of depositors.

APRA considers the risks arising from an ADI's lack of preparedness for zero and negative interest rates to be material since this could have significant implications for an ADI's risk management, hedging, operational processes, contracts, product disclosures, IT and accounting systems among other areas. Insufficient preparation for the possibility of zero and negative interest rates could therefore have an adverse impact on an ADI, its customers and the markets in which it operates.

Accordingly, APRA has set out below its proposed expectations for ADIs' preparedness for zero and negative interest rates. In developing these expectations, APRA has taken into consideration the responses received from ADIs to its December 2020 letter and international experience.

APRA's proposed expectation

In order to ensure that ADIs can operate with zero and negative interest rates, if required, APRA expects ADIs to take reasonable steps to prepare for scenarios in which the cash rate and/or market interest rates may fall to zero or become negative.

More specifically, APRA expects ADIs to, at a minimum, develop *tactical solutions* to implement zero and negative market interest rates and cash rate by 30 April 2022. Tactical solutions are typically shorter-term fixes, involving workarounds on the periphery of existing systems, along with overrides in downstream systems.

All products and activities are in scope for this expectation, except for lending products that do not reference the cash rate or a market rate including business lending, residential mortgages, personal loans and credit cards. Solutions that generate an economic outcome that is the same as a negative interest rate are acceptable, subject to the appropriate risk management considerations.

In developing tactical solutions, APRA expects ADIs to consider all aspects of the products and activities that are in scope including customer communications and disclosures. Further, ADIs should assess the associated operational risks and ensure that there are appropriate controls in place to manage them. ADIs should also consider any relevant conduct related issues, including the potential for conflicts of interest, fair treatment of clients, and asymmetry of information.

Consultation

ADIs can comment and provide feedback on the expectations outlined in this letter by emailing NegativeRates@apra.gov.au by 20 August 2021 and copying their responsible supervisor. APRA intends to finalise its zero and negative interest rate expectations by 31 October 2021.

Yours sincerely,

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