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Dear Ms Richards

## Revised APG 223 - Residential Mortgage Lending

The Australian Bankers' Association (**ABA**) appreciates the opportunity to provide comments on *APG 223 – Residential Mortgage Lending*.

With the active participation of its members, the ABA provides analysis, advice and advocacy for the banking industry and contributes to the development of public policy on banking and other financial services. The ABA works with government, regulators and other stakeholders to improve public awareness and understanding of the industry's contribution to the economy and to ensure Australia's banking customers continue to benefit from a stable, competitive and accessible banking industry.

The ABA is generally supportive of attempts to collect more accurate and meaningful data and acknowledges that APRA sees this new reporting standard and associated reporting form as enabling the collection of information deemed to be essential to APRA's supervisory activities. There does however appear to be a growing level of prescription appearing in APRA practice guides which are potentially leading to a rules and compliance based approach rather than a principles and risk based approach. This may lead to ADIs own risk appetite settings mirroring or becoming subordinate to these expectations which may not result in better risk management and/or customer outcomes.

The ABA have a number of comments regarding the consultation.

### Other concurrent regulatory reforms

#### Revisions to Basel III

In the likely event capital floors are introduced for IRB Banks necessitating parallel reporting, then this will be another reporting cost that will affect both IRB and standardised banks. In this regard, it would also make sense for APRA to defer finalising ARF 223.0 until the revised standardised approach has been finalised and published to avoid any misalignment. For example, under the revised standardised approach the LVR banding does not fully align with ARF 223.0 and it is unclear if the loan to income banding in ARF 223.0 will be applied to determine whether 'repayment is materially dependent on cash flows generated by property'. Ideally, a number of these reports should be aligned to avoid unnecessary costs and duplication of reporting processes.

#### APRA/ABS/RBA Economic and Financial Statistics Modernisation Program

The ABA strongly urges APRA to give serious consideration to the inconsistencies between the proposed Reporting Standard ARS 223 and the mortgage book data to be requested as part of the imminent 'APRA/ABS/RBA Economic and Financial Statistics (**EFS**) Modernisation Program'.



The key differences between the new EFS forms and APRA's proposed ARS 223 reporting standard appears to be the reporting of owner occupied and Investor data. The EFS forms are aligned to the current ARF 320.0 and ARF 320.8, where that existing reporting is based on the purpose of the funds being drawn. In contrast, it appears that the proposed ARS 223 requires this to be based on the underlying security of the borrowings irrespective of the purpose of the funds. This will cause a large divergence between the proposed EFS and ARS 223 reports, in particular where funds are drawn for non-housing purposes (capital for small business, investments, personal expenditure etc.) but are secured against a residential property.

The ABA questions the divergence of APRA's prudential supervision of an ADI and the proposed statistical reporting. In addition to seeking APRA's guidance on the rationale for these reporting differences, the ABA requests that APRA provide guidance for each instance where similar information would be requested under the new prudential Reporting Standard ARS 223, and would also be required to be reported on the EFS forms (ARF 720.1A, 743.0 and 744.0).

The ABA considers it an unreasonable regulatory red-tape impost to proceed with these reforms ahead of the other concurrent regulatory reforms discussed earlier. Additionally, the ABA does not see the justification in requiring ADIs to report similar information on two different formats.

Given this, the ABA request that APRA:

- Articulate the rationale for the differences in reporting definitions between prudential and statistical reporting standards.
- Consider the cost and practical ability for each ADI to report on this different basis.
- Where possible, align the reporting instructions between Prudential and Statistical reporting.
- Concurrently commit to retiring the current ad-hoc quarterly mortgages data request given that this information will be incorporated into the proposed ARF 223 form.

In February 2017, the ABA intends to make a further submission on the APRA Discussion Paper: *Residential mortgage lending reporting requirements for authorised deposit-taking institutions* and the Reporting Standard ARS 223.0. It is likely that the ABA position will further evolve as we and our individual members turn their focus to these APRA proposals.

### **Cost Benefit**

The ABA does not believe a standalone cost benefit consideration of just ARF 223.0 will adequately reflect the costs incurred in this change. The implementation and ongoing costs need to consider the cost of the current reporting obligations (i.e. the semi-permanent adhoc reporting on residential mortgages) and other imminent reporting changes relating to mortgages e.g. the revised standardised approach and the APRA/ABS/RBA EFS Modernisation Program.

### **Comments on the revised prudential practice guide**

The below table contains some technical comments on the draft APG 223.



Section	#	APRA Paragraph	ABA comment	ABA recommended changes
Serviceability assessments	32	<p>Good practice would apply a buffer over the loan's interest rate, <del>usually the standard variable rate</del>, to assess the serviceability of the borrower (interest rate buffer). This approach would seek to ensure that potential increases in interest rates do not adversely impact on a borrower's capacity to repay a loan. The buffer would reflect the potential for interest rates to change over several years. <u>APRA expects that ADI serviceability policies should incorporate an interest rate buffer of at least two percentage points. A prudent ADI would use a buffer comfortably above this.</u></p>	<p>The ABA view is that it may not always be appropriate to apply a minimum 2 per cent buffer, particularly in periods where rates are at a peak of the cycle and unlikely to rise further.</p> <p>The paragraph as it stands fails to consider that a number of ADIs also have subsidiaries that operate outside Australia (i.e. New Zealand) and would therefore have different market conditions to the domestic market.</p>	<p>The ABA recommends that APRA substitute <i>"APRA expects that ADI serviceability policies should incorporate an interest rate buffer of at least two percentage points. A prudent ADI would use a buffer comfortably above this."</i></p> <p>with</p> <p><i>"APRA expects that ADI serviceability policies should incorporate an interest rate buffer which is appropriate for the current position within the interest rate cycle, appropriate to the particular conditions of that market and the particular point of the interest rate cycle in that jurisdiction"</i></p>
Suitably prudent period	35	<p>APRA also expects ADI's to use a suitably prudent period for assessing the repayment of outstanding credit card or other revolving personal debt when calculating a borrower's expenses.</p>	<p>The ABA notes that often, bank customers, when managing their finances may choose different methods (other than full repayment) in repaying their credit card and revolving credit debt at a certain points in time, often in order to achieve a particular financial strategy or personal goal.</p>	



Section	#	APRA Paragraph	ABA comment	ABA recommended changes
Borrowers income	39	<p>Prudent practice is to apply discounts of at least 20 per cent on most types of non-salary income; in some cases, a higher discount would be appropriate. In some circumstances, an ADI may choose to use the lowest documented value of such income over the last several years, or apply a 20 per cent discount to the average amount received over a similar period.</p>	<p>For this paragraph, ABA members would welcome guidance by way of examples.</p> <p>The ABA would argue that some non-salary income should be considered relatively stable despite fluctuations (e.g. high proportion of essential services who undertake shift work e.g. nurses and police), and these types of income should not attract a 20% or higher haircut. Therefore the ABA recommend that APRA should refer to 'non-stable' rather than 'non-salary' income.</p> <p>In addition, the ABA views the phrase "<i>the last several years</i>" as being an excessive duration. The ABA would suggest that two years is a reasonably prudent timeframe to look at for non-stable income.</p> <p>Finally, the ABA requests clarity be provided by way of examples, as to some of the circumstances in which an ADI may choose to use the lowest documented value of such income or apply a 20 per cent discount to the average amount received over a similar period.</p>	



Section	#	APRA Paragraph	ABA comment	ABA recommended changes
Hardship loans and collections	97(a)	<p>APRA has observed varying practices with respect to the treatment of and prudential reporting on <u>loans with hardship (or similar payment concessions) loans</u>. Sound practices in this area would include:</p> <p>arrears would continue to accrue <u>based on the original scheduled payments</u> until the loan is brought back into performing status. <u>ADIs would not freeze or re-age loans where hardship (or other similar payment) concessions have been granted</u>. If necessary, an ADI could have a separate means of reporting arrears <u>internally where the loan has been reclassified as a hardship loan for collection purposes</u>;</p>	<p>The ABA considers the current wording of paragraph 97(a) is unclear as it could imply that an ADI should not re-age an account that has had hardship assistance at any point in time; (i.e. must be perpetually reported as delinquent/in default unless arrears are repaid naturally to cure the delinquency).</p> <p>This would represent a significant change from current practices. ABA members would welcome further APRA guidance by way of examples on how to correctly interpret this paragraph.</p>	<p>For clarity, it is recommended that APRA amends this paragraph so that it reads “...ADIs would not freeze or re-age loans while they are subject to hardship (or other similar payment) concessions, and until a period of 6 month serviceability has been demonstrated.”</p>

Should APRA have questions regarding the views of the ABA and its members, we are most willing to assist. The ABA looks forward to the continued dialogue with APRA in 2017.

Yours sincerely

*Signed by*

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